

ERIA Research Project Report FY2024, No. 03

Enhancing Cambodia's Growth through Economic Integration

by

Rashesh Shrestha

Dionisius A. Narjoko

Salvador Buban



Enhancing Cambodia's Growth through Economic Integration

Economic Research Institute for ASEAN and East Asia (ERIA)
Sentral Senayan II 6th Floor
Jalan Asia Afrika No. 8, Gelora Bung Karno
Senayan, Jakarta Pusat 10270
Indonesia

© Economic Research Institute for ASEAN and East Asia, 2024

ERIA Research Project Report FY2024 No. 03

Published in June 2024

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form by any means electronic or mechanical without prior written notice to and permission from ERIA.

The findings, interpretations, conclusions, and views expressed in their respective chapters are entirely those of the author/s and do not reflect the views and policies of the Economic Research Institute for ASEAN and East Asia, its Governing Board, Academic Advisory Council, or the institutions and governments they represent. Any error in content or citation in the respective chapters is the sole responsibility of the author/s.

Material in this publication may be freely quoted or reprinted with proper acknowledgement.

Foreword

Cambodia has pursued a policy of economic openness with great effect to attract foreign investment and grow the economy since the early 1990s. The 1993 Law on Investment set the tone for this, drawing in investment – especially to the textile sector. Another significant contributor to Cambodian rapid economic growth was joining regional and multilateral organisations. The country became a member of the Association of Southeast Asian Nations (ASEAN) in 1999 and the World Trade Organisation in 2004. As a member of ASEAN, it has also established trade agreements with East Asia Summit countries.

Broadening and deepening economic integration will ensure Cambodia's continued economic growth by diversifying its economy. Cambodia's enthusiasm for such an approach can be seen by its early and whole-hearted enthusiasm for the Regional Comprehensive Trade Agreement (RCEP), of which it became an active member the day it entered into force, on 1 January 2022. In addition to contributing to strengthening the regional architecture, Cambodia may wish to seek bilateral engagements with strategically important trade partners to further diversify its economy, with bilateral partnerships providing an opportunity to reap the benefits of allowing parties to undertake deeper commitments to further reducing barriers to trade.

This study, *Enhancing Cambodia's Growth through Economic Integration*, looks at the factors that Cambodia should consider as it embarks on undertaking free trade agreement (FTA) discussions. To maximise the benefits of FTAs, careful consideration must be given to their design and content. The report provides recommendations in this regard and discusses lessons learned from the impact of existing FTAs. The study also focuses on India as a potential candidate for pursuing a trade agreement to illustrate factors and variables that must be taken into consideration.

Recent years have thrown up an unprecedentedly high number of shocks in the global trading order. Perhaps the best defence for Cambodia to mitigate against such volatility is to expand its variety of exports and increase preferential destination markets, while simultaneously strengthening its position in the global value chain. Trade agreements that can meet such criteria are critical. I very much hope that *Enhancing Cambodia's Growth through Economic Integration* will elucidate the deliberations of the Government of Cambodia as it considers developing trade agreements in the future.

ERIA was honoured to undertake this study, and hopes that its content proves useful. We would like to convey our sincere thanks to the Government of Cambodia, particularly our counterparts at the Ministry of Commerce, and all line agencies for their fulsome help, support, and cooperation in the development of this study.



Tetsuya Watanabe
President, Economic Research Institute of ASEAN and East Asia

Acknowledgements

This report was prepared by the Economic Research Institute for ASEAN and East Asia (ERIA) project team members, comprising Salvador Buban, Jeremy Gross, Michelle Chandra Kasih, Dionisius Narjoko, and Rashesh Shrestha, with the support of several external experts. Sothea Oum of the Center for Strategy and Innovation Policy (CSIP), Cambodia also provided project leadership.

The authors would like to thank all the project team members as well as their ERIA colleagues, especially Fukunari Kimura, Anita Prakash, and Shujiro Urata.

The following authors provided background papers that contributed to the preparation of this report: Sothea Oum, executive director, CSIP, Cambodia; Misa Okabe, associate professor, Wakayama University, Japan; Ramonette Serafica, senior research fellow, Philippine Institute for Development Studies, Philippines; Archanun Kohpaiboon, associate professor, Thammasat University, Thailand; Myrna Austria, full professor, De La Salle University, Philippines; Tomohiro Machikita, associate professor, Center for Southeast Asian Studies (CSEAS), Kyoto University, Japan; Kiyoyasu Tanaka, Institute of Developing Economies–Japan External Trade Organization, Japan; Ngov Penghuy, director, Nagoya University Cambodia Satellite Campus, Cambodia; Veeramani Choorikkadan, associate professor, Indira Gandhi Institute of Development Research, India; Erdenebat Bataa, head, Economics Department, National University of Mongolia, Mongolia; Rinta Jaya, consultant; Paul Gibbons, consultant; and Lili Yan Ing, lead advisor, South-East Asia, ERIA.

The authors received generous support and commitment from several officials of the Ministry of Commerce, Government of Cambodia, under the guidance of HE Pan Sorasak, back then served as Minister of Commerce. They are also grateful for the participation of officials from many other agencies and ministries in Cambodia.

Finally, the authors would also like to thank Praveen Kumar Agarwal, The Energy and Resources Institute (TERI); Sachin Chaturvedi, Research and Information System for Developing Countries (RIS); and Shankaran Nambiar, Malaysian Institute of Economic Research (MIER) for their insightful comments.

Table of Contents

	Foreword	iii
	Acknowledgements	iv
	List of Figures	vi
	List of Tables	vi
	Executive Summary	vii
	Policy Recommendations	xi
Chapter 1	Background	1
Chapter 2	Cambodia's Economic Profile	2
Chapter 3	India as a Potential FTA Partner	25
Chapter 4	Trade and Investment Environment in India	38
Chapter 5	Potential Impact of Bilateral FTAs	42
	References	44

List of Figures

Figure 2.1	Real GDP per Capita by Year, Selected Countries	2
Figure 2.2	Parts and Components as a Percentage of Cambodia's Total Manufacturing Imports and Exports	8
Figure 2.3	Composition of Cambodia's Exports of Global Value Chain Products	9
Figure 2.4	Total Investment by Countries Recorded by the CDC in 2021	10
Figure 2.5	Economic Activity in SEZs	11
Figure 3.1	Value of India's Exports to the World, 1993–2019	25
Figure 3.2	Composition of India's trade in Global Value Chain Products	26
Figure 3.3	Share of AMS in Trade with India, 2019	28
Figure 3.4	Cambodia's Merchandise Exports and Imports from India	30
Figure 3.5	Tariff Reduction Schedules Under the AIFTA	35

List of Tables

Table 2.1	Cambodia's Key Economic Indicators	4
Table 2.2	Cambodia's Imports and Exports of Goods by Product and Destination	5
Table 2.3	Composition of Cambodia's Services Trade, 2019	7
Table 2.4	Cambodia's Free Trade Agreements	13
Table 2.5	FTA Utilisation Rates in Cambodia's Imports from East Asian Countries by Product MFN Tariff Level, 2019	15
Table 2.6	FTA Utilisation Rate in Cambodian Imports by HS Chapter Group, 2019	16
Table 2.7	Number of 6-Digit HS Tariff Lines Imported from Various Sources, 2018	19
Table 2.8	Composition of ASEAN–India Trade, 2019	24
Table 3.1	Cambodia's Major Exported and Imported Products to/from India	31
Table 4.1	India Tariff Rates by Sector and Trade Partner/Preferential Trade Agreement, 2020	38
Table 4.2	India's Trade Agreements with East Asia	40
Table 5.1	Share of Sample Workers in CSES Data Sets	39

Executive Summary

Cambodia's impressive economic growth over the past 2 decades, averaging more than 8.0% per year, has been driven by international trade and investment. Trade has grown robustly, and liberal investment policy has attracted foreign direct investment (FDI). Cambodia is also continuously enacting reforms to reduce trade transaction costs through national initiatives, and is implementing various multilateral, regional, and bilateral agreements. Cambodia's trade growth has been supported by its membership of the World Trade Organization (WTO), the Generalized System of Preferences, and several free trade agreements (FTAs). The Association of Southeast Asian Nations (ASEAN) FTA, the ASEAN–China FTA, and other ASEAN Plus One FTAs have facilitated Cambodia joining the downstream of global value chains (GVCs). The ASEAN FTA has had positive impacts on Cambodia's export values in a few products in the agriculture, primary, and labour-intensive sectors.

While external trade has been key to Cambodia's economic growth, it is not yet broad-based. Garment exports still account for two-thirds of manufacturing exports, and two markets – the United States (US) and the European Union (EU) – account for 60% of merchandise exports. Likewise, Cambodia's services trade is highly dependent on travel and tourism. As reliance on few sectors carries high risk, Cambodia must seek to diversify its export-oriented economic activities. This is already recognised in its latest trade development strategy. Medium to high value-added agriculture is a potential area in which Cambodia can have a comparative advantage given its resource endowment and level of economic development. Greater integration into international production networks also needs to be pursued, which requires additional FDI as well as domestic provision of complementary services such as logistics and business processing.

FTAs with key trade partners can serve as vehicles for achieving Cambodia's economic objectives by fostering deeper trade relationships. Cambodia is active in this aspect. As an ASEAN Member State (AMS), Cambodia has signed the intra-ASEAN trade agreement and joined ASEAN's trade agreements with Australia, China, India, Japan, the Republic of Korea (henceforth, Korea), New Zealand, Hong Kong, and the Regional Comprehensive Economic Partnership (RCEP). To develop the country, Cambodia is pursuing further economic liberalisation and global integration on a bilateral basis. In this regard, it recently signed FTAs with China (effective 1 January 2022) and Korea (effective 1 December 2022), and signing the Cambodia–UAE Economic Partnership Agreement (CEPA) on 8 June 2023, as well as beginning discussions with the Eurasian Economic Union.

Bilateral agreements can lead to deeper commitments, develop Cambodia as a platform for connecting larger economies, help strengthen strategic/political relationships with more countries, and allow Cambodia to engage more directly in the international trading

architecture. While the potential benefits from FTAs are large, realising those benefits requires careful design and consideration of relevant costs. The actual content of the FTAs will determine whether Cambodia can reap the potential benefits. This report is an outcome of the Economic Research Institute for ASEAN and East Asia (ERIA) study conducted to examine how Cambodia can maximise the benefits of greater economic integration with key trade partners.

To maximise the benefits, new FTAs should consider the current economic situation in Cambodia and in the FTA partner countries. The design of the FTAs, such as their scope (whether to include only goods or also services, investment, and new emerging issues) and appropriate design of key provisions, needs to be carefully thought out. The rules of origin (ROO) must be carefully designed to consider the production model used by Cambodian manufacturers. More liberal and trade-facilitative ROO – such as a change in tariff sub-headings or specific production processes – may be needed to make the FTA beneficial for specific sectors. The agreement should also try to avoid burdensome administrative and documentation requirements; otherwise, it will be too costly for the private sector to take advantage of any preferential treatment provided by the FTA and discourage its utilisation. There are also strategic considerations about how FTAs can be leveraged for maximum benefit in the context of Cambodia's existing trade relationships.

It should be noted that bilateral FTAs are complementary to other strategies for deeper engagement with trade partners. This includes increasing the utilisation of existing unilateral preferential treatment provided to Cambodia by the US and the EU, as well as the bilateral FTAs. In addition, Cambodia could engage with trade partners by working in conjunction with other ASEAN economies. This includes forming production networks with other fast-growing AMS to produce goods for larger markets and engaging with trade partners at the ASEAN level. A regional approach is more likely to increase Cambodia's bargaining position, particularly with large partners. A regional approach also creates more opportunities for establishing international production linkages, as inputs can be sourced from multiple countries. Ultimately, Cambodian policymakers need to determine the appropriate mix of bilateral and regional approaches suited to Cambodia's situation, noting the country's resource availability to engage in these negotiations.

International trade integration must be matched with domestic reforms, such as trade facilitation, elimination of non-tariff barriers, increased transparency of non-tariff measures (NTMs), and good practices in regulatory management. Cambodia has some good practices in this regard, e.g. the Government–Private Sector Forum, implementation of the national single window, reviewing of the Custom Law, amongst other reforms. There is some scope for bilateral cooperation in trade facilitation and private sector engagement with traders in both countries. In addition, the competitiveness of Cambodia's goods and services will determine whether any FTA produces the expected benefits. Therefore, Cambodia needs to optimise the use of existing trade facilities. Domestic reforms to build competitiveness should go hand in hand with gaining market access through FTAs, honing human capital/skills, and upgrading product

quality/standards. Domestic firms also need to develop the capacity to meet a large volume of demand.

This ERIA study also examined the possibility of Cambodia pursuing an FTA with India. India's economic profile, its existing relationship with ASEAN, and its absence from the RCEP make it an important strategic trade partner for Cambodia. Not only does India have a large market for Cambodia's exports, India's strengths in services and technology products – if imported to Cambodia – could improve the productivity of the Cambodian economy. An FTA could be a vehicle for additional Indian investment in Cambodia's business operation and information technology (IT) sector, where India is already heavily engaged in overseas FDI. This would enhance Cambodia's services sector and increase opportunities for GVC integration. India is also a potential source of imported inputs, which would deepen Cambodia's engagement in global production sharing. India also stands to benefit from greater market access to Cambodia in some sectors of interest. Through an FTA with Cambodia, it could expand on its existing bilateral trade relationships with AMS. Cambodia could also potentially be a source of key inputs for India's manufacturing sector.

The study shows potential beneficial impacts on specific sectors. Analysis conducted using the Global Trade Analysis Project Model shows that a Cambodia–India FTA would have minimal effects, mostly due to low existing trade between the two countries.

Lessons drawn from the impact of Cambodia's existing FTAs – including the ASEAN–India Free Trade Area (AIFTA) – show varied impacts across products and the FTA in question. Although the AIFTA has had a positive effect on Cambodia's trade values and variety with India, its effect is still smaller than those from other FTAs such as the ASEAN Free Trade Area and the ASEAN–China FTA. The AIFTA has had few employment effects in Cambodia, which is reassuring, and could be further evidence of less competition and more complementarity in Cambodia–India trade. Nonetheless, social policies will be needed to mitigate any potential negative impacts of FTAs. Based on qualitative interviews with firms, agricultural exporters seem to be optimistic about a Cambodia–India FTA, but textiles producers are unsure about the Indian market. Further dialogue with key domestic producers is thus necessary.

A bilateral FTA with India would need to address several issues. While tariffs are generally liberalised through them, India's agriculture sector has generally remained protected through high tariffs. While India has provided some concessions in this sector through bilateral deals (e.g. with Malaysia), the chance of further tariff reductions on agricultural products depends on India's domestic political climate. Provisions in a bilateral deal with India must be more expansive than those contained in the AIFTA and cover emerging issues not previously considered. Current provisions on the ROO in AIFTA could be reconsidered to reduce compliance costs for businesses. To accomplish this, it is essential to identify best practices in other FTAs, for which the RCEP could be a good starting point and a basis for negotiation, as it covers many emerging issues in

international trade relationships. Cambodia's experience in the RCEP negotiations will provide lessons for future FTA negotiations; lessons learned from recently concluded FTAs with China and Korea can be applied as well.

NTMs would need to be streamlined, harmonised, and made more transparent by including a provision for a bilateral mechanism or platform to address issues faced by traders. Likewise, ROO would have to be carefully negotiated to avoid placing undue burdens on firms; otherwise, firms will be discouraged from utilising the FTA. Furthermore, ROO must allow the expansion of backward linkages within GVCs in Cambodian manufacturing. The FTA must also demonstrate adequate commitment to the domestic reforms necessary to attract foreign investors.

Regarding the political economy of a successful trade deal between Cambodia and India, Cambodia will not be considered a threat due to India's large trade surplus. This contrasts with India's position vis-à-vis the RCEP, from which it ultimately withdrew due to fear of an influx of imports from some member countries. On a related note, one potential area of concern is India's view of the recently signed FTA between Cambodia and China. ERIA's discussions with experts suggest that India would be open to deeper bilateral engagement with AMS, including Cambodia. However, given the current state of India–China trade relations and India's position vis-à-vis the RCEP, China's dominant role in ASEAN's supply chain could make negotiations on ROO more challenging.

Policy Recommendations

- New FTAs will change the economic incentives and resource allocation within Cambodia, creating feedback for Cambodia's existing trade relationships, including those with the US, the EU, and China. Thus, identifying the potential for synergy between existing trade relationships and new engagements is important.
- Gains from FTAs would be higher if, in addition to tariff cuts, efforts were made to remove non-tariff barriers through trade facilitation measures and simplified and trade-facilitative ROO. Likewise, the gains could be larger if FTAs enhanced productivity and service sector trade between the countries. Thus, to maximise economic benefits, FTAs should include not only trade in goods but also additional elements such as services, investment, NTMs, and trade facilitation. A comprehensive agreement is more costly in terms of the time and resources needed for negotiation, but the benefits of such an approach are likely to be greater.
- NTMs must be streamlined, harmonised, and made more transparent by including a provision for a bilateral mechanism or platform to address issues faced by traders.
- India's economic profile makes it a strategic trade partner with which Cambodia could consider a deeper economic relationship. The overall goal of any Cambodia–India trade negotiations should be to enhance existing bilateral arrangements. Cambodia and India already have multiple economic arrangements at the institutional level, including the AIFTA and the Duty-Free Tariff Preference facility for least developed countries extended by India. However, as current trade between Cambodia and India is limited to a few sectors, the utilisation of these facilities is very low. Nonetheless, recent data show increasing trends in automotive and pharmaceutical imports by Cambodia from India and natural rubber exports by Cambodia to India, which could be key sectors to highlight during bilateral discussions.

Chapter 1

Background

In several public declarations, the Government of Cambodia has expressed an interest in expanding its economic relationship with major global players. Besides participating in regional blocs as well as international bilateral economic cooperation, the government envisages establishing bilateral free trade agreements (FTAs) to enhance exports and promote the economic growth of the country, especially with countries that are parties to the Association of Southeast Asian Nations (ASEAN) Plus One FTAs. In this regard, Cambodia has signed bilateral FTAs with China and the Republic of Korea (henceforth, Korea), and has begun discussions with the Eurasian Economic Union.

Establishing bilateral FTAs offers many potential benefits for Cambodia. In recent years, bilateral FTAs have become an important vehicle for economic liberalisation, with more than 500 FTAs and regional trade agreements reported to the World Trade Organization (WTO) as of 2020. FTAs allow countries to avoid the slow movement or 'deadlock' of multilateral trade negotiations. The bilateral nature of negotiations can lead to deeper commitments and liberalisation than possible in a multilateral setting. Commitments made in multilateral settings are shallower and often exclude many products or sectors. One key area where bilateral FTAs have gone beyond multilateral arrangements is in the case of investment. Currently, there is no multilateral agreement on international investment, but numerous bilateral investment treaties and regional investment agreements are in place. This is important because trade and investment go hand in hand, particularly with the rise in multinational companies whose global value chains (GVCs) are located across many jurisdictions. Thus, bilateral FTAs can be an effective vehicle for Cambodia to pursue deeper economic cooperation with key trade partners to maintain its high growth rate.

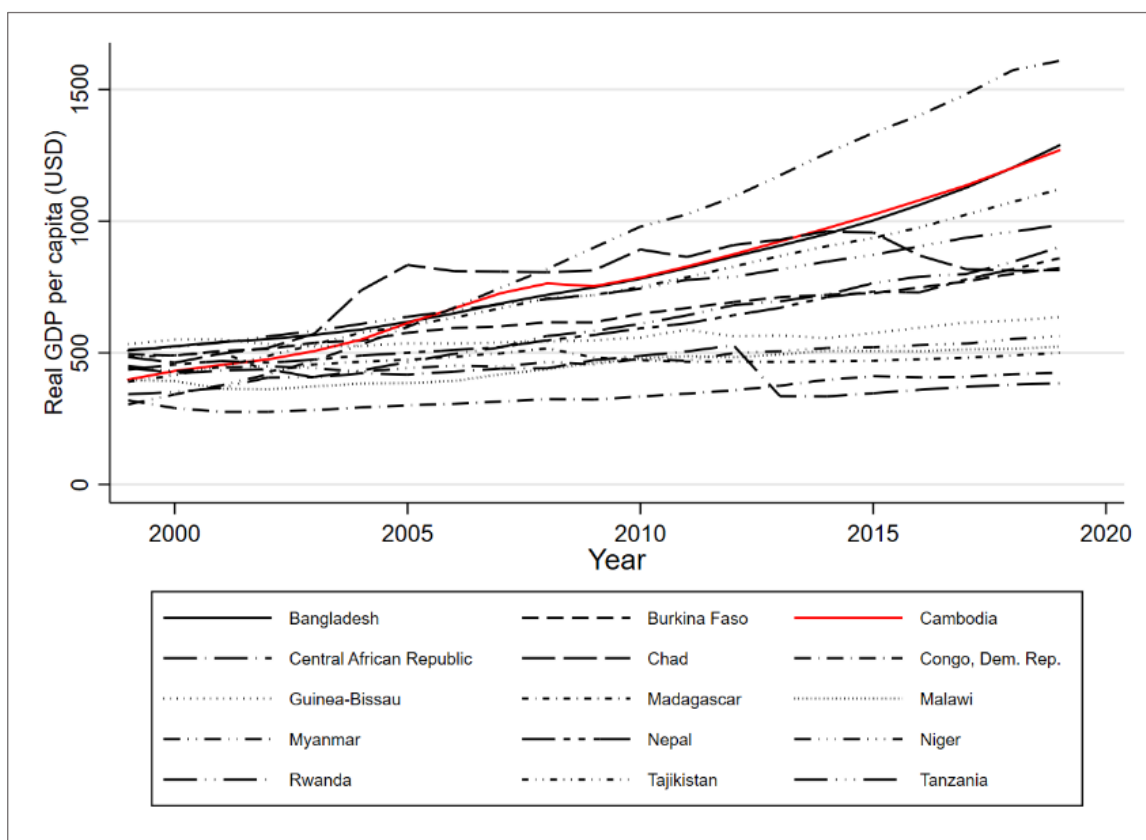
However, to maximise the benefits, new FTAs should consider the current economic situation in Cambodia and in the FTA partner countries. The design of the FTA, such as its scope (whether to include only goods or also services, investment, and new emerging issues) and appropriate design of key provisions, needs to be carefully thought out. Supportive domestic policies and reforms are also needed to maximise FTA benefits by making it easier to utilise the FTAs. There are also strategic considerations about how FTAs can be leveraged for maximum benefit in the context of Cambodia's existing trade relationships. This report highlights these issues for Cambodian policymakers' consideration.

Chapter 2

Cambodia's Economic Profile

Cambodia's robust gross domestic product (GDP) growth over the past 2 decades –8.0% on average during 1999–2019 – has been driven by international trade and foreign direct investment (FDI). Figure 2.1 compares the evolution of Cambodia's GDP per capita during 1999–2019 with countries that had similar GDP per capita in 1999. Cambodia was amongst the best performing developing countries during this period.

Figure 2.1. Real GDP per Capita by Year, Selected Countries



GDP = gross domestic product.

Source: Authors' calculation from World Bank data

(<https://data.worldbank.org/indicator/NY.GDP.PCAP.KD> [Accessed 24 March 2022]).

Trade and investment have been an important part of this growth story. Cambodia's goods exports increased from \$1.39 billion in 2000 to \$14.70 billion in 2019, with average annual growth of 14% over 2000–2019. Services comprised almost 30% of exports in 2019, up from 23% in 1999, and the volume of services exports has grown threefold since 2010. Imports also increased from \$1.44 billion in 2000 to \$20.30 billion in 2019, with an average annual growth of 15%. The share of total trade (i.e. imports plus exports) in its

GDP increased from 111% in 2000 to 125% in 2018. Cambodia also witnessed a massive surge in FDI, increasing from \$118 million in 2000 to \$3,624 million in 2020 – average annual growth of more than 100%. During the 2010s, before the disruptions caused by the coronavirus disease (COVID-19), Cambodia saw double-digit growth in imports and exports (Table 2.1). If this economic performance continues, the country could soon graduate from lower middle-income status.

Along with rapid economic growth, Cambodia is experiencing structural change, with manufacturing and services fast becoming the engine of the country's growth. As shown in Table 2.1, Cambodia underwent rapid industrialisation during 2010–2019, with the average annual growth of industry at 11%, and its share of GDP increased from 22% in 2010 to 34% in 2019. The average growth of agriculture was 1.7% and its share reduced from 34% to 21%, while the growth of services was 7% and its share remained at 38% in 2019. Employment in the industry sector increased from 25% of total employment in 2015 to 29% in 2019, while that of the agriculture sector declined from 42% to 32% over the same period.

For continued growth in these sectors, it is necessary for Cambodia to gain access to larger markets, adopt advanced foreign inputs and technology, develop its human capital, and attract investment in key sectors such as:

1. new industries or manufacturing ventures with the capability of breaking into new markets, with high value-added products, creative and highly competitive that focuses not only on consumer products but also production equipment such as machinery assembly, mechanic/electronic/electric equipment assembly, means of transport assembly, and natural resource processing;
2. small and medium-sized enterprises in all sectors, especially those involved in drugs and medical equipment production, construction materials, packaging equipment for export, furniture manufacturing, and industrial equipment, etc.;
3. agro-industrial production for export and domestic markets;
4. various types of supporting industries for the agriculture, tourism, and textile sectors as well as for industries serving regional production chains linked with either global markets or GVCs in the form of forward linkages and for industries linked with the provision of raw materials supply networks in the form of backward linkages, especially for the garment sector, for the production of spare parts and assembly of other semi-finished products; and
5. industries serving regional production lines and those of future strategic importance such as information and communication technology (ICT), energy, heavy industries, cultural/historical/traditional handicrafts, and green technology.

Table 2.1. Cambodia's Key Economic Indicators

Panel A: Macroeconomic Indicators				
GDP Component	2010	2019	Share of GDP, 2019 (%)	Average Growth Rate, 2010–2019 (%)
Population (million)	14.3	16.5	-	1.6
Real GDP (\$ million)	11,242.3	20,921.0	-	7.0
Real GDP per capita (\$)	785.5	1,269.0	-	5.4
Household consumption (\$ million)	9,139.1	15,221.2	72.8	6.1
Investment (\$ million)	1,952.5	4,476.8	21.4	8.2
Foreign direct investment, net inflows (BOP, current \$ million)	1,404.3	3,663.0	13.5	16.0
Imports of goods and services (current \$ million)	6,691.5	16,921.4	62.5	10.5
Exports of goods and services (current \$ million)	6,080.1	16,549.2	61.1	13.3
Panel B: Economic Structure				
Economic Sector	2010 (current \$ million)	2019 (current \$ million)	Share of GDP, 2010 (brackets) and 2019 (%)	Average Growth Rate, 2010–2019 (%)
Agriculture	3,808.5	5,610.7	(33.9) 20.7	1.7
Industry	2,458.5	9,271.6	(21.9) 34.2	11.3
Services	4,306.4	10,523.7	(38.3) 38.9	6.7

GDP = gross domestic product, BOP = Balance of payments.

Source: World Bank (n.d.), World Development Indicators,

<https://datatopics.worldbank.org/world-development-indicators/> (accessed 1 May 2021).

One widely acknowledged risk in Cambodia's growth performance is that exports are heavily dependent on a small number of products and services, and on only a few destinations. Goods exports are dominated by textiles, clothing, and footwear products, comprising about 70% of total goods exports in 2019 (Table 2.2). Tourism remains Cambodia's largest services export sector, with 82% of the country's commercial services exports attributed to this sector (Table 2.3). Diversifying the country's export base – both in terms of products and markets – is crucial for continued growth. This is emphasised in Cambodia's Trade Integration Strategy, 2019–2023 (Kingdom of Cambodia, 2019).

Table 2.2. Cambodia's Imports and Exports of Goods by Product and Destination

(a) By products

HS code	Product description	Value	Share
		(\$'000)	(%)
Imports			
60	Knitted or crocheted fabrics	2,682,356	13.23
87	Vehicles other than railway/tramway rolling stock	2,377,574	11.72
27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes.	2,368,044	11.68
84	Nuclear reactors, boilers, machinery, & mechanical appliances	1,350,383	6.66
85	Electrical machinery & equipment & parts thereof	1,069,102	5.27
55	Man-made staple fibres	1,009,892	4.98
39	Plastics and articles thereof	758,647	3.74
52	Cotton	645,933	3.19
48	Paper & paperboard; articles of paper pulp	513,265	2.53
72	Iron and steel	478,442	2.36
Exports			
61	Articles of apparel & clothing accessories, knitted or crocheted	6,001,442	40.48
62	Articles of apparel & clothing accessories, not knitted or crocheted	2,285,307	15.42
64	Footwear, gaiters, and the like	1,267,884	8.55
42	Articles of leather; saddlery & harness, etc.	1,104,101	7.45
85	Electrical machinery & equipment & parts thereof	577,470	3.9
87	Vehicles other than railway/tramway rolling stock	442,321	2.98
71	Natural/cultured pearls, precious/semi-precious stones	438,097	2.96
10	Cereals	421,802	2.85
94	Furniture; bedding, mattresses, etc.	420,181	2.83
43	Furskins and artificial fur, etc.	289,646	1.95

Table 2.2. *Continued*

(b) By destination

2019			2019		
Country/region	Value (\$'000)	Share (%)	Country/region	Value (\$'000)	Share (%)
ASEAN10	7,977,131	39.34	EU	4,886,299	32.96
China	7,585,748	37.41	United States	4,414,282	29.78
Japan	887,661	4.38	ASEAN10	1,334,982	9.01
EU	804,460	3.97	Japan	1,140,013	7.69
Korea, Rep. of	673,164	3.32	China	1,012,148	6.83
Hong Kong	541,936	2.67	Canada	839,309	5.66
United States	318,354	1.57	Hong Kong	240,815	1.62
India	191,962	0.95	Korea, Rep. of	212,559	1.43
Canada	121,656	0.60	Australia	133,882	0.90
Australia	72,886	0.36	Mexico	77,724	0.52

ASEAN = Association of Southeast Asian Nations, EU = European Union, HS = Harmonized System.

Sources: United Nations (n.d.), UN Comtrade Database, <https://comtrade.un.org/> (accessed 1 February 2021); and World Bank (n.d.), World Integrated Trade Solution, <https://wits.worldbank.org/> (accessed 1 February 2021).

Table 2.3. Composition of Cambodia's Services Trade, 2019

Product/Sector	Exports (%)	Imports (%)
Commercial services	100.00	100.00
Goods-related services	0.00	0.00
Transport	13.16	52.86
Travel	82.03	29.17
Other commercial services	4.81	17.94
Construction	0.48	2.97
Insurance and pension services	0.17	4.90
Financial services	0.50	0.13
Charges for the use of intellectual property n.i.e.	0.13	0.70
Telecommunications, computer, and information services	1.59	4.59
Other business services	1.79	4.30
Research and development services	0.00	0.00
Professional and management consulting services	0.00	0.00
Technical, trade-related, and other business services	1.79	4.30
Personal, cultural, and recreational services	0.15	0.32
Audio-visual and related services	0.00	0.00
Other personal, cultural, and recreational services	0.15	0.32
Services not allocated		
Total value of commercial services trade (\$ million)	6,027	3,161

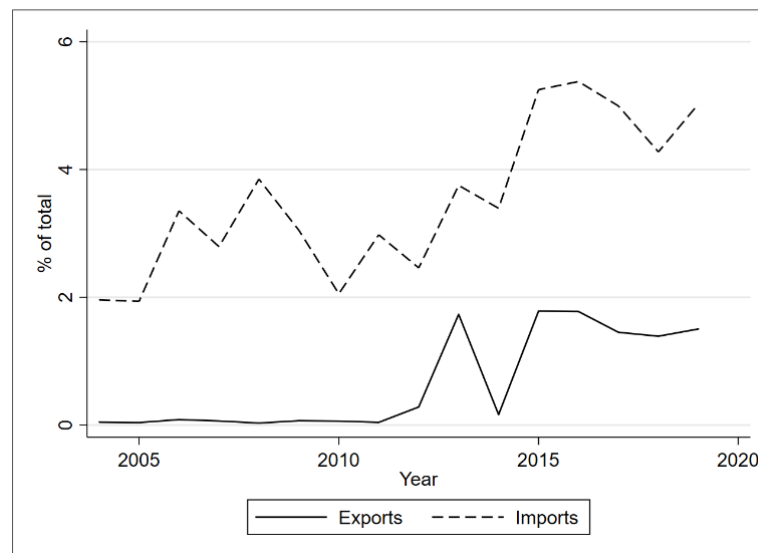
n.i.e. = not included elsewhere.

Source: World Trade Organization (n.d.), WTO Data, <https://data.wto.org/> (accessed 23 December 2020).

The country has made some progress in product variety – the cumulative share of the top 30 exported items in total exports accounted for 89.2% in 2011 before dropping to 57.2% in 2019. Yet, the diversity of its export markets remains unchanged – the cumulative share of the top 30 export destinations accounted for more than 90% of total exports and remained unchanged from 2011 to 2019. Cambodia's global exports totalled \$14.8 billion in 2019, including \$4.4 billion to the United States (US) and \$3.9 billion to the European Union (EU) (30% and 26% of Cambodia's total exports of goods, respectively). The other main export destinations were Japan, Korea, and Thailand. Cambodia's exports to its main trading partners in the region (the 15 Asian countries that are members of ASEAN Plus One FTAs) totalled \$3.9 billion or 26% of Cambodia's goods exports to the world. An FTA with large economies could help Cambodia's trade diversification, enhance its competitiveness for attracting higher quality FDI, and leverage its participation in the GVC.

Cambodia's engagement in international production networks is also rising. The share of parts and components has noticeably increased since 2014 in both imports and exports (Figure 2.2). Figure 2.3 shows that Cambodia's participation in GVC products is concentrated on final apparel as well as intermediate electronics and vehicles. Intermediate goods are imported, mainly from China, for garment manufacturing, machinery, and electrical appliances. However, there is room for improvement in the country's engagement with GVCs. Cambodia's global production sharing engagement largely involves final goods assembly by using imported inputs (i.e. a single transformation) and has not induced many domestic backward linkages. Its operation remains within economic enclaves, with limited domestic firm participation. It is important to address this limitation quickly to distribute the benefits of economic integration widely.

Figure 2.2. Parts and Components as a Percentage of Cambodia's Total Manufacturing Imports and Exports

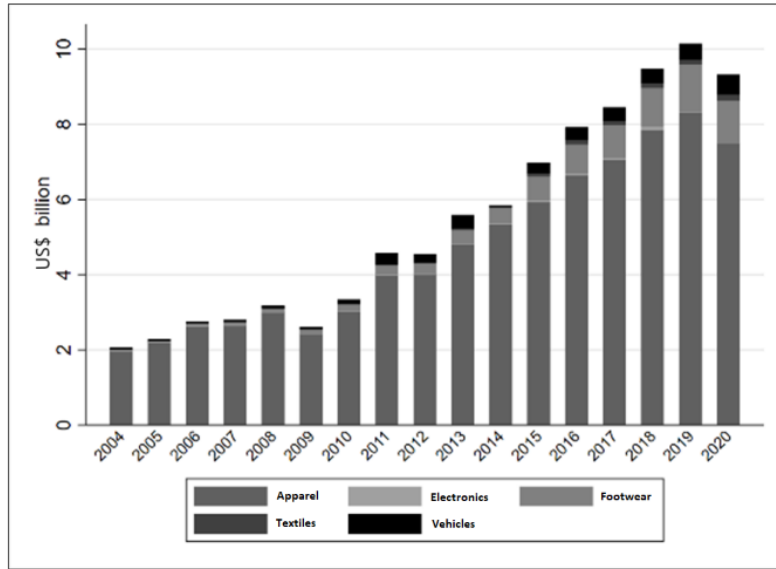


Note: The definition of parts and components is based on Broad Economic Classification (BEC) classification code 42 and 53.

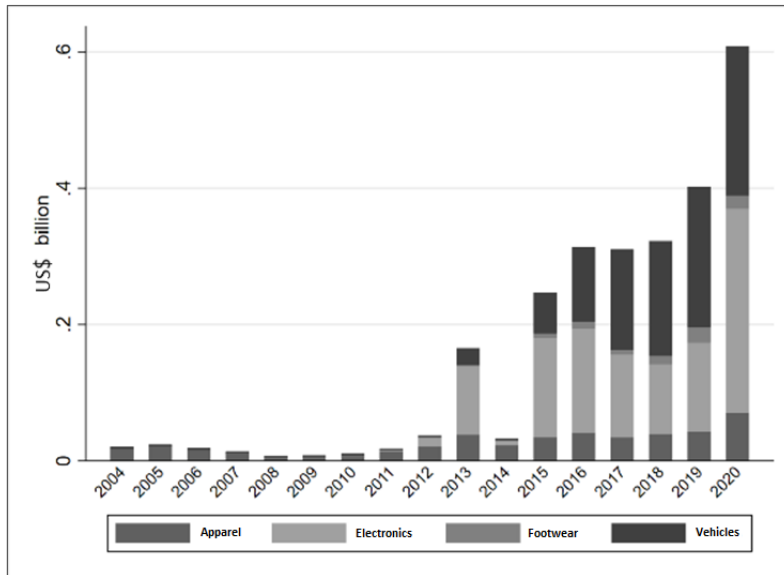
Source: Authors' illustration using data from World Integrated Trade Solution database (<https://wits.worldbank.org/> [Accessed 10 August 2023].)

Figure 2.3. Composition of Cambodia's Exports of Global Value Chain Products

(a) Cambodia's Export of Final Products



(b) Cambodia's Export of Intermediate Products



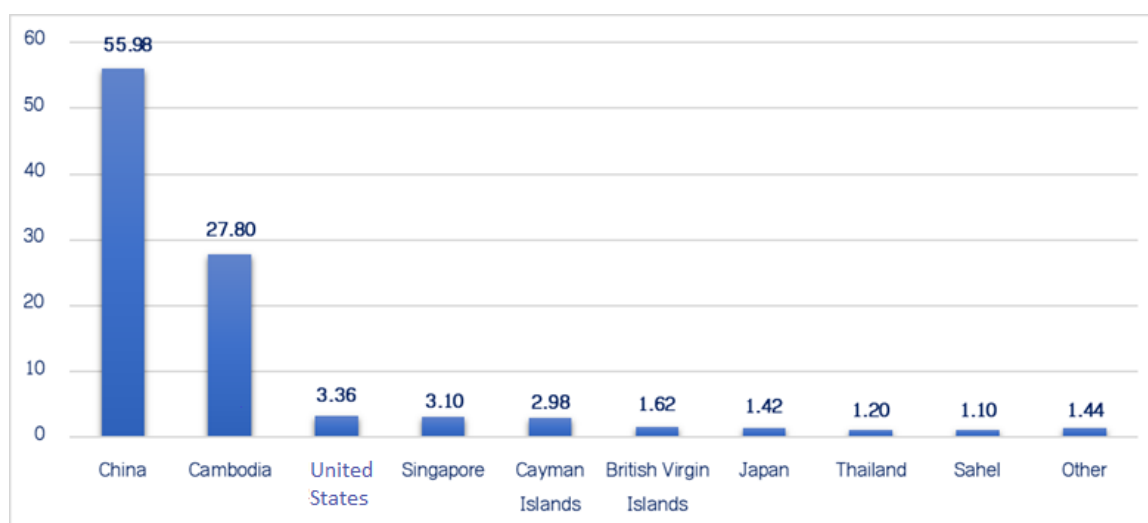
Source: Authors' calculation from World Integrated Trade Solution database (<https://wits.worldbank.org/> [Accessed 10 August 2023].)

Cambodia is well placed to integrate further into the global production network. The country enjoys a central location in a large, dynamic region and has the potential to be a major destination for new investments in labour-intensive manufacturing as neighbours like China and Thailand move up the value chain to more capital-intensive products. External factors – such as rising wages and rental costs in China and Thailand, and production disruption caused by floods in Thailand in 2011 – seem to have contributed to Cambodia's attractiveness as a new host country within regional production networks. The country needs to focus on increasing its intrinsic attractiveness regarding global production sharing activities, which can be done by deepening its trade relationships with

key export markets and improving the domestic economic environment. Diversifying Cambodia’s engagement in international production networks is important to maximise the use of domestic resources. This requires a coordinated approach to engage with all trade partners through FTAs.

Cambodia has attracted FDI through its liberal policy. As of 2021, the Council for the Development of Cambodia (CDC) reported that it had registered Qualified Investment Projects (QIPs) both outside and inside special economic zones (SEZs) totalling \$4.35 billion, of which \$1,210 million (27.80%) came from local investors. As shown in Figure 2.4, countries’ investments in QIPs were led by China at \$2,438 million (55.98%), followed by the US at \$146.32 million (3.36%), Singapore at \$134.81 million (3.10%), and other countries at \$424.96 million (9.77%).

Figure 2.4. Total Investment by Countries Recorded by the CDC in 2021 (%)



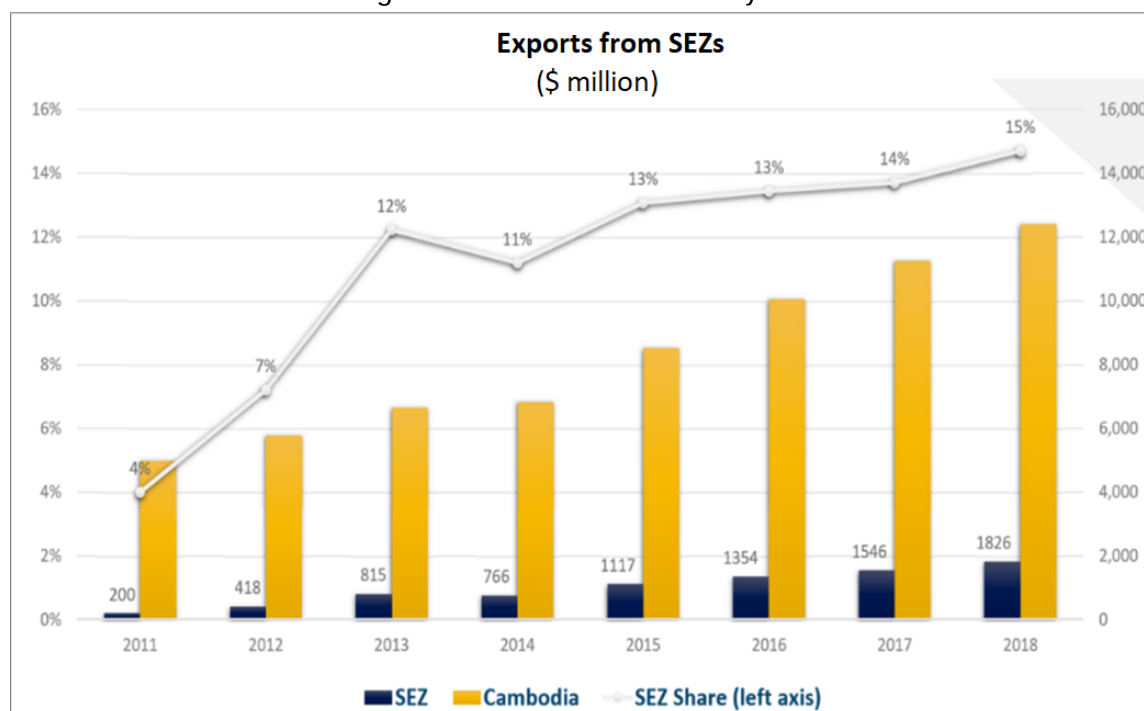
CDC = Council for the Development of Cambodia.
Source: Council for the Development of Cambodia.

1. Trade and Investment Environment

A conducive domestic policy environment is necessary to maximise the benefits of new FTAs, and Cambodia has been making progress in this regard. The country has pursued a liberal trade and investment policy. Joining ASEAN in 1999 and the WTO in 2004 has helped its international integration. Cambodia is also facilitating trade and investment activities through SEZs. These zones provide business entities with favourable access to land leases, infrastructure, and services to facilitate the set-up and operation of businesses. Services available in SEZs include utilities, tax services, customs clearances, and other administrative services designed to support import–export processes. QIPs located in these zones are entitled to the same incentives and protections as other QIPs set forth in the New Investment Law of Cambodia.

As of 2019, Cambodia had 54 SEZs (*Khmer Times*, 2020). The importance of SEZs in exports is also rising, with 15% of exports in 2018 arising within SEZs (Figure 2.5). Most recently, Cambodia has taken steps to transform the Sihanoukville SEZ into a multipurpose SEZ to enhance its role in industrial activity.

Figure 2.5. Economic Activity in SEZs



SEZ = special economic zone.

Source: Chen, K. (2021), 'The Progress of Cambodian Special Economic Zones: Export-Import Procedure and Reform on Issuing Certificate of Origin (C/O) of Ministry of Commerce', 6 October. https://www.aseankorea.org/aseanZone/downloadFile2.asp?boa_filenum=5298

Cambodia continues to liberalise its investment regime and create an attractive environment for investors. The new law on investment of Cambodia (promulgated on 15 October 2021) aims to establish an investment regime with an open, transparent, predictable, and favourable legal framework to attract and promote quality, effective, and efficient investments by Cambodian nationals or foreigners. Under the new law on investment, Cambodia encourages FDI in additional sectors by providing more incentives to areas such as research and development intensive high-tech industries; high value-added manufacturing; activities engaging in regional and global production chains; activities supporting agriculture, tourism, and manufacturing; and others (Chipman Koty, 2022). The sub-decree on implementation of the law on investment, which still in the pipeline, is expected to list investment activities that are eligible for incentives. Possible incentives (depending on certain criteria) stipulated in the law include income tax exemption, value-added tax exemption, and tax deduction facilities for some activities that enhance productivity.

The new law on investment provides flexibility to the government to exercise its discretion to offer special incentives to specific sectors and investment activities that have high potential to contribute to Cambodia's national economic development.

In addition to incentives, the law grants investors many guarantees and protections for their investments, as it includes clauses on non-discrimination; protections against nationalisation, expropriation, and price controls; free purchase and repatriation of foreign currencies; and the protection of intellectual property rights.

The services sector in Cambodia in general is open and conducive to international trade in services, most notably in the financial sector, including insurance, tourism, legal services, telecommunications, and digital services. Professional services appear to have some restrictions, such as those relating to the medical, accounting and auditing, and legal services professions. In medical services, foreign medical professionals, paramedical professionals, and medical aid professionals can exercise their professions in private hospitals or clinics. Accounting professionals who wish to practise in Cambodia are normally required to become a member of one of the professional bodies in the country and are not required to take further examinations. This is a very open measure compared with the restrictions applied in other countries. Further, foreign accountants from countries whose professional organisations have a reciprocity agreement with Cambodia may practise in the country. For legal services, all foreign lawyers and firms must obtain authorisation to practise in relation to Cambodian law from the Bar Association of the Kingdom of Cambodia. This authorisation can only be granted if the country of origin of the foreign lawyer has a reciprocal arrangement with the Bar Association of the Kingdom of Cambodia.

The Government of Cambodia is committed to improving the protection of intellectual property in the country. It created a national intellectual property strategy and has enacted key intellectual property regulations. The government has also acceded to several international intellectual property rights protocols, including the World Intellectual Property Organization (1995), the Paris Convention for the Protection of Industrial Property (1998), the Madrid Protocol (2015), the Hague Agreement Concerning the International Registration of Industrial Design (2017), the Lisbon Agreement for the Protection of Appellations of Origin and their International Registration (2018), and the Berne Convention for the Protection of Literary and Artistic Works (2020). Cambodia has three institutions responsible for intellectual property protection: the Ministry of Commerce (MOC) is responsible for trademarks, geographical indication, trade secrets, and undisclosed information; the Ministry of Industry, Science, Technology, and Innovation is responsible for patents, design, and plant variety protection; and the Ministry of Culture and Fine Arts is responsible for copyrights and related rights. The National Committee for Intellectual Property, chaired by the MOC, coordinates the three institutions.

2. Existing Preferential Trade Arrangements

Cambodia is very open to and active in bilateral and regional FTAs. As an ASEAN Member State (AMS), it has FTAs with other AMS and is a party to the ASEAN Plus One FTAs with Australia, China, India, Japan, Korea, and New Zealand. It has also ratified the Regional Comprehensive Economic Partnership (RCEP), the preferential trade agreement amongst ASEAN and its five FTA partners (excluding India), which entered into force on 1 January 2022. In addition, it signed bilateral FTAs with China and Korea in 2020 and 2021, respectively, and is pursuing discussions with the Eurasian Economic Union. In total, Cambodia has seven FTAs with its main trading partners, covering 63% of the country's exports and imports. Table 2.4 lists the FTAs involving Cambodia which are in effect or have been initiated.

Table 2.4. Cambodia's Free Trade Agreements

Name	Partners	Status	Entry into force for Cambodia
ASEAN Free Trade Area	ASEAN	In effect	17 May 2010
ASEAN–China FTA	ASEAN, China	In effect	1 July 2005
ASEAN–Korea FTA	ASEAN, Rep. of Korea	In effect	1 Jun 2007
ASEAN–Japan CEPA	ASEAN, Japan	In effect	1 Dec 2009
ASEAN–India FTA	ASEAN, India	In effect	1 Jan 2010
ASEAN–Australia–New Zealand FTA	ASEAN, Australia, and New Zealand	In effect	4 Jan 2011
ASEAN–Hong Kong FTA	ASEAN, Hong Kong	In effect	11 Jun 2019
RCEP	ASEAN, Australia, China, Japan, Rep. of Korea, New Zealand	In effect	1 Jan 2022
Cambodia–China FTA	Cambodia, China	In effect	1 Jan 2022
Cambodia–Korea FTA	Cambodia, Rep. of Korea	In effect	1 Dec 2022
Cambodia–Eurasian Economic Union FTA	Cambodia, Armenia, Belarus, Russia, Kazakhstan, Kyrgyz Republic	Under consultation/ study	Not in effect yet

ASEAN = Association of Southeast Asian Nations, CEPA = Comprehensive Economic Partnership Agreement, FTA = free trade agreement, RCEP = Regional Comprehensive Economic Partnership. Source: Authors' compilation from various sources.

To understand how existing FTAs have affected Cambodia's trade, we conducted a gravity analysis, which is a standard way of using historical bilateral trade data to estimate the impact of FTAs. Our analysis has found that, in general, Cambodia's trade growth has been supported by FTAs. In particular, the ASEAN FTA and the ASEAN–China FTA have facilitated Cambodia joining the downstream of GVCs. The ASEAN FTA has had positive impacts on Cambodia's export values in a limited number of products in the agriculture, primary, and labour-intensive sectors. The ASEAN–China FTA has had a positive impact on Cambodia's imports of textiles and fabrics from China. Thus, the ASEAN–China FTA seems to have taken on a significant role in developing regional production networks in the textile and apparel industry between Cambodia and China. ASEAN FTAs have also increased Cambodia's import value from AMS in a wide range of sectors. In addition, they have facilitated Cambodia increasing the variety of exports and imports.

The extent to which FTAs have been beneficial can be assessed by their utilisation rates. An FTA utilisation rate is defined as trade under an FTA regime expressed as a percentage of total trade in FTA-eligible products. A high utilisation rate means that a larger proportion of products that are eligible for preferential tariffs are traded under that regime. Table 2.5 reports the share of imports from East Asia that utilised the relevant FTA. Since the incentive to utilise an FTA emerges due to high most favoured nation (MFN) tariffs, we distinguish between products with different levels of MFN tariffs imposed by Cambodia. As expected, the utilisation rates tend to be higher in products with higher MFN tariffs. In some cases, high MFN products may be imported even when they do not qualify for FTA treatment. In most cases, FTA utilisation in Cambodian imports is low. This could be due to other non-FTA concessions provided by Cambodia for some products, e.g. imports into export processing zones, or products not meeting origin criteria. There could also be a lack of understanding of FTAs amongst Cambodian importers, which should be rectified. A better understanding of the prevailing FTA utilisation rate through detailed discussions with importers is necessary.

Table 2.5. FTA Utilisation Rates in Cambodia's Imports from East Asian Countries by Product MFN Tariff Level, 2019

Partner	All products	MFN = 7	MFN = 15	MFN = 35
Australia	0.3%	0.7	0.0	2.8
Brunei	0.0	0.0	0.0	
China	7.9	6.3	16.3	13.6
Indonesia	14.2	14.1	44.5	98.6
India	22.5	8.1	16.3	60.5
Japan	0.3	0.9	0.5	0.0
Republic of Korea	7.7	2.4	1.7	58.5
Lao PDR	26.2	0.1	15.3	100.0
Myanmar	11.2	11.2	17.5	0.0
Malaysia	29.4	43.2	46.3	89.6
New Zealand	18.9	23.1	0.0	0.0
Philippines	41.2	53.1	3.2	27.6
Singapore	17.6	44.8	5.4	78.9
Thailand	33.4	31.6	47.2	89.1
Viet Nam	6.3	6.4	16.7	29.2

FTA = free trade agreement, MFN = most favoured nation.

Note: Numbers indicate the percentage of imports under the relevant FTA.

Source: Authors' calculation from Cambodian Ministry of Commerce trade data.

Another way to examine the FTA utilisation rates is by product groups (Table 2.6). In 2019, FTA was most utilised in imports of primary products from East Asia (Harmonized System (HS) chapters 1–24). The ASEAN Trade in Goods Agreement was heavily utilised in importing wood products, metals, and electronics from Indonesia; miscellaneous articles from Malaysia; plastic, rubber, hides, and skins from Myanmar; and transport products from Thailand. The use of the ASEAN–Australia–New Zealand FTA for imports is relatively limited to wood products from New Zealand. Utilisation of the ASEAN–China Free Trade Area and the ASEAN–India Free Trade Area concentrates on agricultural products, while that of the ASEAN–Korea Free Trade Area focuses on food products.

Table 2.6. FTA Utilisation Rate in Cambodian Imports by HS Chapter Group, 2019

Partner	HS 1-15	HS 16-24	HS 25-27	HS 28-38	HS 39-43	HS 44-49	HS 50-63	HS 64-67	HS 68-83	HS 84-85	HS 86-89	HS 90-99
Australia	0.2%	9.8										
Brunei												
China	64.7	11.8	2.6	4.2	1.4	17.8	0.2	1.2	19.2	16.1	22.1	5.4
Indonesia	47.1	11.9	0.9	33.9	2.4	75.6	3.9	2.0	73.9	84.3	39.5	38.5
India	59.0	1.9		0.3	0.0	11.7		29.6	0.1	16.8	45.7	
Japan		1.1		0.4	0.0		1.5		0.5	0.1	0.2	
Rep. of Korea		88.3	32.1	1.2	0.6	15.6	0.5		0.2	7.4	0.5	8.7
Lao PDR	97.5	15.4	9.6									
Myanmar	3.7	1.8			97.6							
Malaysia	65.1	92.8	3.9	25.2	24.7	39.2	0.2	59.5	68.2	14.9	25.3	85.6
New Zealand						99.5						
Philippines	70.7	87.3		0.7	0.1			74.3	40.4	2.8		15.5
Singapore	11.1	89.3	3.9	29.0	0.7	8.4			20.0	1.3		
Thailand	45.8	79.0	13.9	42.3	5.4	27.1	8.1	37.6	19.3	21.9	52.4	46.3
Viet Nam	15.9	18.9	1.7	7.3	11.7	7.7	1.5	0.2	5.9	23.8	2.3	30.8

FTA = free trade agreement, HS = Harmonized System.

Note: Blank cells indicate no imports.

Source: Authors' calculation from Cambodian Ministry of Commerce trade data.

On the export side, maximising the FTA utilisation rates of Cambodian exporting firms will be an important step in maximising the benefits of FTAs. To truly benefit from any FTA, firms need to be able to understand and utilise the FTA's preferences. To understand the situation in Cambodia, we conducted a focus group discussion with some firms in Cambodia. Most participants understand the importance of having preferential market access as a core element for firm competitiveness. They understand the importance of the Everything but Arms (EBA) initiative to the EU market, the Generalized System of Preferences (GSP) to the US market, and other non-reciprocal duty-free and quota-free measures provided to Cambodia. However, as those measures fall away as the country graduates from least developed country (LDC) status, the respondents acknowledge the need to expand the external market base through multilateral or bilateral FTAs. Nonetheless, most appear to have a very limited understanding of an FTA. Only a few have a vague understanding that an FTA could increase their exports. For example, garment manufacturing companies still believe that the EU and US markets are far more attractive, probably because most manufacturing firms in Cambodia are mostly foreign-invested firms that generally produce medium- or high-end products for the EU or US markets under an original equipment manufacturing contract.

Given the current perception of some firms and their lack of information on the destination market, organising events to promote the understanding of FTAs – including establishing FTA websites to provide information on the benefits and challenges – is important. Government officials should engage the private sector, including local chambers of commerce, in these tasks – not only to help them understand FTAs but also to gather support. A stakeholder network involving the private sector could provide valuable information for understanding the Indian market as well as the possible risks and challenges – good inputs for future FTA negotiations.

Besides bilateral and multilateral FTAs, Cambodia is also a recipient of unilateral tariff preferences from other countries, which has helped boost its exports. From the EU and the US – its two main export destinations – Cambodia uses the EBA and GSP initiatives, which provide duty-free access to almost all products. These facilities are likely to no longer be available once Cambodia graduates from its LDC status, however. Moreover, unlike FTAs, the eligibility status of these preferential schemes can be withdrawn unilaterally if certain conditions are not met.¹ Engaging through an FTA can avert the potential loss of duty-free market access in non-binding preferential arrangements such

¹ Cambodia's eligibility under the EBA scheme was suspended from 12 August 2020 due to non-trade-related conditionalities – human rights concerns – by the EU. The EU may remain open for further engagement with Cambodia if it conducts the necessary reforms. This partial withdrawal of Cambodia's EU market access resulted in about 20% of Cambodia's exports to the EU – e.g. garments, footwear, and travel goods – becoming subject to MFN status. At the same time, Cambodia may lose this facility where less stringent ROO are applied for several products in parallel with the partial withdrawal of the EBA initiative. This does not affect the remaining 80% of Cambodia's exports under the preferential duty-free quota-free access to the EU market.

as the GSP. From a long-term perspective, continued access to these markets will depend on the competitiveness of Cambodia's products, which in turn depends on its ability to source the needed inputs as cheaply as possible. Furthermore, Cambodia must look to other markets to expand its exports. For this, Cambodia will need to rely on existing trade relations with ASEAN and its partners under bilateral and regional frameworks.

Given the non-binding nature of unilateral trade preference schemes such as the GSP, developing countries and LDCs – particularly smaller economies – should consider negotiating binding commitments to secure their market access to developed countries or certain developing countries, including through FTAs. Developing countries and LDCs can also opt to negotiate as a bloc in regional agreements to strengthen their bargaining power, as Cambodia and the Lao People's Democratic Republic (Lao PDR) have negotiated economic agreements as part of the ASEAN bloc with major economies such as Australia, China, India, Japan, Korea, and New Zealand.

2.1. FTAs in the Overall Trading Environment

While FTAs play an important role in expanding trade between FTA partners, agreements must be kept in the context of the complex international trade architecture that now consists of several overlapping agreements. These multiple and sometimes overlapping FTAs raise strategic issues that go beyond simple cost-benefit calculations. Any new FTA will change economic incentives and resource allocation within Cambodia, creating feedback for Cambodia's existing trade relationships. Thus, identifying the potential for synergy between existing trade relationships and new engagements is important.

Considering the current situation in Cambodia, the country should work to optimise existing FTAs and prioritise FTAs with its main trading and investment partners. Cambodia is on the right track regarding a trade integration agenda. Considering its limited budget and resources, the country may wish to manage its bilateral FTAs engagement carefully and not spend much time and energy on concluding many bilateral and regional agreements. In the short term, Cambodia should focus on optimising the current GSP facilities and preferential tariff arrangements, including trade and investment facilities offered by its existing FTAs.

Another approach is to take advantage of ASEAN integration to form production linkages with neighbouring countries to produce goods that can be traded with non-ASEAN trade partners. Larger and more developed AMS like Indonesia, Malaysia, Singapore, and Thailand, and emerging countries like Viet Nam have formed deep trade linkages with non-AMS. In addition to direct engagement with its non-ASEAN trade partners, Cambodia could benefit strategically from existing relationships formed by other AMS. Table 2.7 shows the number of 6-digit HS tariff lines imported from various sources. Cambodia still has room to catch up with other AMS in terms of exports and imports. Its exporting activity is concentrated amongst five AMS: Indonesia, Malaysia, Singapore, Thailand, and Viet Nam, but with only a few tariff lines being exported.

Table 2.7. Number of 6-Digit HS Tariff Lines Imported from Various Sources, 2018

Importer	Source country											
	BRN	KHM	IDN	LAO	MYS	MMR	PHL	SGP	THA	VNM	ASEAN	World
BRN	...	67	970	2	2,617	23	465	2,467	1,210	566	3,125	3,757
KHM	1	...	509	15	1,143	75	262	1,209	2,090	1,593	2,729	3,658
IDN	99	348	...	73	2,993	277	1,130	3,516	2,678	2,010	4,077	4,760
LAO	5	23	83	...	219	14	44	320	2,554	1,522	2,810	3,257
MYS	412	289	2,440	34	...	337	1,080	3,341	2,913	1,964	4,050	4,790
MMR	42	102	935	70	1,494	...	325	1,260	2,804	1,430	3,252	4,131
SGP	339	477	3,120	106	3,889	661	1,698	...	2,995	2,272	4,224	4,632
THA	226	805	2,474	784	2,855	963	1,558	2,700	...	2,346	3,901	4,822
VNM	17	383	1,799	143	2,112	280	777	1,781	2,650	...	3,445	4,672

ASEAN = Association of Southeast Asian Nations, BRN = Brunei, HS = Harmonized System, IDN = Indonesia, KHM = Cambodia, LAO = Lao PDR, MMR = Myanmar, MYS = Malaysia, PHL = Philippines, SGP = Singapore, THA = Thailand, VNM = Viet Nam.

Note: There are about 5,100 tariff lines at the 6-digit HS nomenclature.

Source: Authors' calculation from World Integrated Trade Solutions data (<https://wits.worldbank.org/> [accessed 15 April 2022]).

2.2. Cooperation Measures and Mechanisms of FTAs

As Cambodia considers new FTAs, it should play close attention to the design of these agreements. There are important principles to adhere to in designing an FTA structure. Bilateral FTAs should be forward-looking and provide a supportive environment that will encourage further development. In addition, they should not create additional layers of complexity or involve burdensome requirements. As much as possible, bilateral FTAs should use provisions from existing FTAs to which Cambodia is a party, as stakeholders should be familiar with the requirements and conditions of these FTAs. Moreover, bilateral FTAs need to build on and add value to provisions available in existing FTAs. Provisions, especially on ROO, should be more trade-facilitative rather than restrictive.

To maximise the benefits, FTAs should be as broad and far-reaching as possible, covering not just trade in goods but also other topics. Cambodia's FTAs should include an investment chapter, as this can also help it integrate into GVCs. In addition, modern FTAs entail more than market access in the form of tariffs or quotas, but also behind-the-border measures that can be complex – yet important – in improving the business environment by reducing costs, levelling the playing field for foreign investors, and pushing policy reforms towards best practices.

Ideally, trade and investment should be concluded within one agreement, e.g. the North American Free Trade Agreement (NAFTA), the ASEAN–Australia–New Zealand Free Trade Area, and the ASEAN–Korea Free Trade Area. However, other FTAs have separate trade and investment agreements, e.g. the ASEAN–India Free Trade Area (AIFTA), the ASEAN–Japan Comprehensive Economic Partnership Agreement, the EU–Viet Nam FTA, and the EU–Singapore FTA. In these cases, separate agreements were necessary because the parties were unable to reach an agreement for the investment chapter when the trade agreement had been concluded. For FTAs involving the EU, parties wanted to expedite the entry into force, as investment agreements with an investor–state dispute settlement mechanism must be ratified by the national parliaments of all 26 EU member countries.

In addition to deeper market commitments, recent and more modern FTAs like the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the RCEP include new provisions that may not be present in ASEAN Plus One FTAs, such as intellectual property, government procurement, e-commerce, state-owned enterprises, and sustainable development.

On intellectual property, new-generation FTAs often contain deeper commitments with a view to ensuring a transparent and predictable standard for the protection and enforcement of intellectual property rights. For example, the CPTPP commits its parties to several intellectual property treaties, such as the Patent Cooperation Treaty and the World Intellectual Property Organization internet treaties dealing with copyright and related rights in the digital environment. On government procurement, newer FTAs build on the disciplines found in the revised Agreement on Government Procurement regarding

non-discrimination, transparency, procedural fairness, and impartiality to regulate certain activities.

Given the greater importance of e-commerce, new FTAs, such as the CPTPP, recognise this trend and have incorporated new chapters on e-commerce, which contain a set of rules on commitments to not apply duties to products transmitted electronically, to protect personal information, and to cooperate on important security issues in electronic commitments. Similar disciplines can also be found in the RCEP, as well as various US FTAs. Likewise, sustainable development disciplines can be seen clearly in many FTAs such as the CPTPP, the EU–Singapore FTA, and the EU–Viet Nam FTA. The EU's FTAs appear to be the most robust in regulating sustainable development. In these FTAs, the parties have made commitments to corporate social responsibility, high levels of environmental protection, and high levels of labour protection. All these commitments are meant to prevent a race to the bottom.

The inclusion of these new chapters/provisions should be carefully weighed as well as their impact. Cambodian officials should obtain in-depth knowledge of relevant areas that may be imposed by developed countries in an FTA. Developing countries and LDCs must analyse all these new types of commitments more closely and request special and differential treatment provisions as well as technical assistance for their implementation.

Although it is suggested that FTA commitments should be deeper than commitments made in the WTO, Cambodia should be cautious in making such commitments, particularly if they would be too burdensome considering its level of development. Certain flexibility should be negotiated, along with technical assistance, to meet such commitments over an extended period. Cambodia must ensure that special and differential treatment provisions, e.g. longer phase-in periods, treatment of sensitive products, a list of non-conforming measures, and flexibility in ROO, are covered in these FTAs.

2.3. Domestic Reforms

The domestic economic environments of both FTA partner countries determine the extent to which a bilateral deal will enhance trade and investment activities. The World Bank's Ease of Doing Business Index, which compared the policies and regulatory practices of more than 190 countries, ranked Cambodia 144th, 8th amongst AMS, with the Lao PDR and Myanmar closely trailing. The report ranked Cambodia 187th out of 190 countries globally for ease of starting a business.² This signals that much needs to be addressed in terms of simplifying regulations covering business registration, employing workers, paying taxes, and accessing credit.

² <https://archive.doingbusiness.org/en/data/exploreconomies/cambodia> [Accessed 28 Aug 2023].

To help the FTA develop international production linkages, supplementary policies must be undertaken. Firstly, investment to improve Cambodia's infrastructure and logistics service quality must continue, as they contribute greatly to cost-effectiveness in terms of export competitiveness. Secondly, the quality and relevant skills for the workforce, together with education, must be enhanced. Finally, enhancing the capability of domestic firms via market-friendly measures (e.g. cooperation between foreign and domestic firms through fiscal incentive schemes) would ensure adequate financial access.

Cambodia has made significant progress in improving its domestic economic and trading environment. It signed the WTO Trade Facilitation Agreement in 2016 and has introduced many measures to facilitate areas such as customs automation, the national single window (NSW), one-stop border posts, customs risk measures, e-permits and customs, phytosanitary certificates, certificates of origin, and trade registration.

Cambodia has worked closely with development partners to improve the capacity of trade-related government agencies. Amongst them, ARISE Plus Cambodia, financed by the EU and the Government of Germany, has worked closely with the General Department of Customs and Excise (GDCE), the MOC, and other related agencies on trade facilitation reform agendas from 2019 until 2023. The three key components of the ARISE Plus project are (i) improving customs, trade facilitation, and standards; (ii) strengthening institutional capacities and improving regulatory practices for international trade; and (iii) enhancing private sector engagement in trade, notably of small and medium-sized enterprises. Separately, the United Nations Conference on Trade and Development (UNCTAD) stepped up its support to Cambodia, especially to the National Trade Facilitation Committee (NTFC) through its e-learning webinar series as part of the capacity building programme.

Amongst key reforms, the interministerial NTFC was established in 2020 with a clear structure – the secretary of state of the Ministry of Economy and Finance is the chair and the director general of the GDCE is the permanent vice chair. The NTFC has 13 members, 12 of whom are representatives from related government agencies and one is from the Cambodia Chamber of Commerce, representing the private sector. The secretariat of the NTFC is in the GDCE, with support from development partners. On customs procedures, the use of Advanced Rulings for tariff classification, origin, and valuation have increased, and pre-arrival processing has been put into use at major ports. The NSW was instituted in July 2019. Customs is the lead agency for the implementation of the NSW system, and as of July 2020, several major agencies and institutions are participating in the system. Trade-related documents that can be submitted online through the NSW system include export and import permits, certificates of origin, and licences. The use of digital copies of documents is generally allowed by customs for clearance procedures. More agencies have also started to accept such copies. Moving towards greater acceptance of digital copies would enhance the trade process even more. Continuous improvement will further help Cambodia's ambition of global integration.

The new online business registration platform (also known as the Single Portal) was developed by the Ministry of Economy and Finance using the Cambodia Data Exchange (CamDX) system to facilitate and enhance the business environment in Cambodia. With the online platform, business owners can now register their business at the MOC, the General Department of Taxation, and the Ministry of Labour and Vocational Training simultaneously and receive digital licences/certificates upon approval via the online platform. Nevertheless, in the current phase, if the business needs to register with additional ministries/institutions, the business owner is required to follow the respective procedures of the relevant ministries/institutions. Through this new procedure, business registration can take up to only 8 working days and cost much less. Payment of registration services can also be made online electronically. Continuous improvement will further help Cambodia's ambition of global integration.

2.4. Complementary Strategy

In addition to bilateral engagement with trade partners, as a member of ASEAN, Cambodia has the option of pursuing regional – rather than bilateral – engagement. Provided Cambodia's domestic capacity, a regional approach would give the country the ability to gain market access by sourcing inputs from the entire region.

In addition, Cambodia could pursue a complementary strategy of leveraging the existing trade relationships of other AMS with important trade partners. For example, in the case of India (which is discussed further below), our analysis of ASEAN–India trade shows that between 2010 and 2019, ASEAN's exports to India increased from \$37 billion to \$48 billion, while imports from India increased from \$19 billion to \$29 billion. Table 2.8 shows the composition of ASEAN–India trade by HS chapter group. While many commodities are evenly exported and imported, machinery and electronics comprise 27% of ASEAN's exports to India, while 'chemicals' and 'stones, glass, and metal' are imported. Most importantly from Cambodia's perspective, exports of 'textiles and clothing', as well as 'footwear products', have seen rapid growth (although from a relatively small base in 2010) over the last decade. The import of chemicals and transport equipment have also experienced sharp growth.

Table 2.8. Composition of ASEAN–India Trade, 2019

HS group (chapter)	Export share (%)	Import share (%)	Export growth 2010–2019 (%)	Import growth 2010–2019 (%)
Animal and vegetable (01–15)	11.5	10.2	–12.4	80.3
Food products (16–24)	1.4	2.6	32.4	–27.1
Minerals and fuels (25–27)	18.1	17.4	4.2	–32.1
Chemicals (28–38)	10.4	16.8	52.8	111.6
Plastic, rubber, hides, and skins (39–43)	7.4	3.6	56.0	97.7
Wood (44–49)	2.5	0.6	–14.2	66.6
Textiles and clothes (50–63)	2.0	4.0	117.8	37.1
Footwear (64–67)	0.4	0.2	339.3	78.0
Stones, glass, and metals (68–83)	13.5	22.8	183.0	140.6
Machinery and electronics (84–85)	26.9	14.3	27.5	84.7
Transport (86–89)	2.2	5.6	56.1	184.1
Miscellaneous (90–96)	3.8	1.9	49.4	82.2
Total trade (\$ billion)	48.3	28.8		

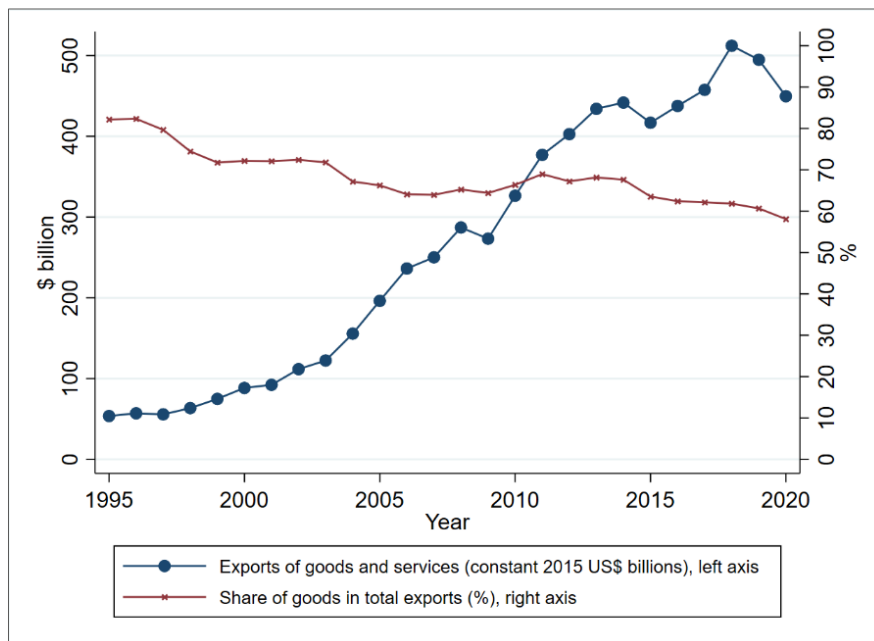
Source: Authors' calculation from ASEANstats (n.d.), <https://www.aseanstats.org/> (accessed 28 March 2022).

Chapter 3

India as a Potential FTA Partner

India's economic profile, its relationship with ASEAN, and its absence from the RCEP make it an important strategic trade partner for Cambodia. India is one of the fastest-growing economies in the world, registering an average annual growth rate of 5.1% during 1999–2019, and reaching per capita income of \$2,152 in 2019. Due to its large domestic market, standard measures show limited trade openness of India: exports of goods and services accounted for only 18% of GDP; imports accounted for 21%. In terms of the total volume of trade, however, India is quite large. The value of India's total exports of goods and services to the world increased from about \$60 billion in 2000 to \$528 billion in 2019. It was the 10th largest merchandise importer and the 17th largest merchandise exporter in 2019. India's trade flattened and declined between 2012 and 2017, but has resumed an upward trend since that time. Figure 3.1 shows the evolution of India's exports to the world.

Figure 3.1. Value of India's Exports to the World, 1993–2019
(\$ billion)



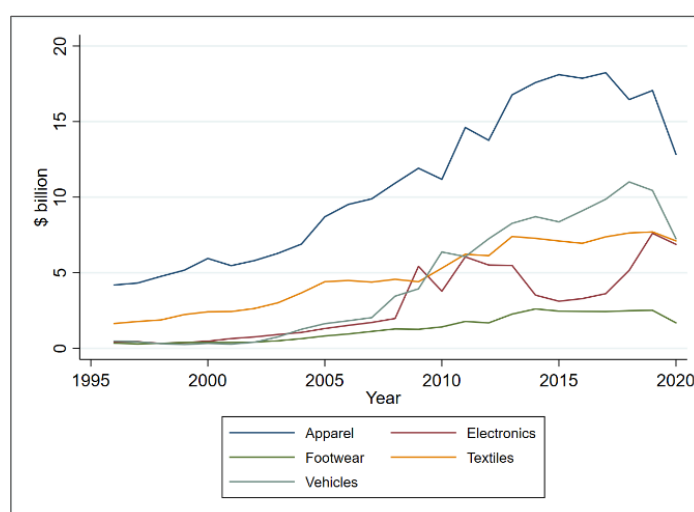
Source: Authors' calculation from World Development Indicators data (<https://databank.worldbank.org/source/world-development-indicators>) [Accessed 30 Feb 2022]

While there is some competition in the apparel market, India's export basket complements that of Cambodia. Similar to Cambodia, manufactured products account for a very large share of India's exports to the world, with final apparel accounting for the

largest share.³ However, Indian exports are more diversified and include significant shares of final vehicles, final textiles, final electronics, and final footwear, some of which compete with Cambodian industries. Across use-based categories, consumer goods account for the largest share, followed by intermediate goods and capital goods. Furthermore, in terms of the technological content of exports, the share of medium- and high-technology products in India's export basket has been increasing, reaching more than 50% in 2019. As for the composition of intermediate GVC products, India's exports to the world are mainly concentrated in intermediate apparel and intermediate vehicles, followed by intermediate electronics (Figure 3.2).

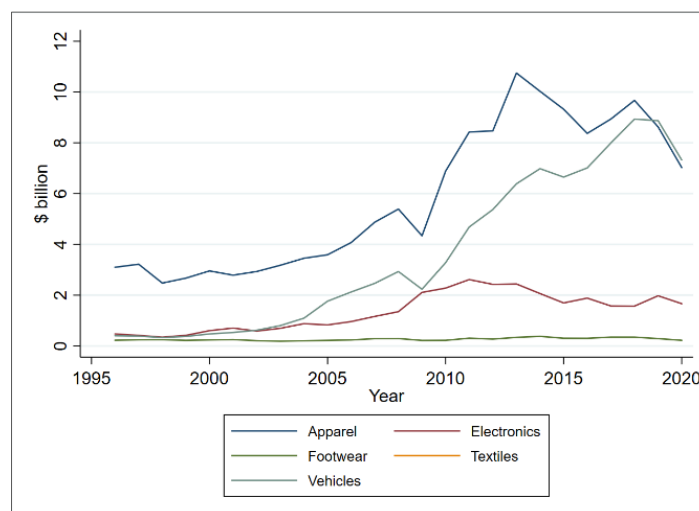
India's large and expanding services sector is also of interest to Cambodia, as it could potentially help Cambodia's manufacturing activity considering the growing 'servicification' of manufacturing. India's services sector comprised half of the GDP and 30% of total employment in 2019. Services' contribution to India's exports increased from 28% in 2000 to almost 40% in 2019. Amongst services, 'other commercial services' account for 75.54% of exports, with key subsectors including 'telecommunications, computer, and information services' and 'professional and management consulting services', both of which are relevant for improving Cambodia's competitiveness. Mode 1, or cross-border supply, dominates in terms of both exports and imports, which is in line with the significance of 'other commercial services' in its services trade. Given India's strengths in these sectors, Cambodia could benefit from deeper engagement in IT, digital, and business services, as well as health care.

Figure 3.2. Composition of India's trade in Global Value Chain Products
(a) Final Products



³ It was ranked seventh globally as an exporter of knitted garments in 2019, two places above Cambodia.

(b) Intermediate Products



Source: Authors illustration from World Integrated Trade Solution data (<https://wits.worldbank.org/> [accessed 15 April 2022]).

Another recent development in India is its large outward FDI in the services sector.⁴ Whereas manufacturing dominated Indian outward FDI flows from 1990 to 2009, today, the services sector is leading outward FDI. That the services sector hosts the largest number of outward-investing firms from India is not surprising, as India has emerged as a services-dominated economy. Moreover, its economic growth since the 1980s has been services-led. Various factors have contributed to the global competitiveness of India in broad areas of services such as ICT, ICT-enabled services, contract research and development, legal services, business services, and similar activities. These factors include technological progress; improved telecommunications infrastructure; and the availability of low-cost, highly skilled human resources. Indian service providers in several activities, including those in ICT and ICT-enabled services, have also realised that they cannot provide effective and secure services along with adequate after-sales support without having a local presence in overseas markets.

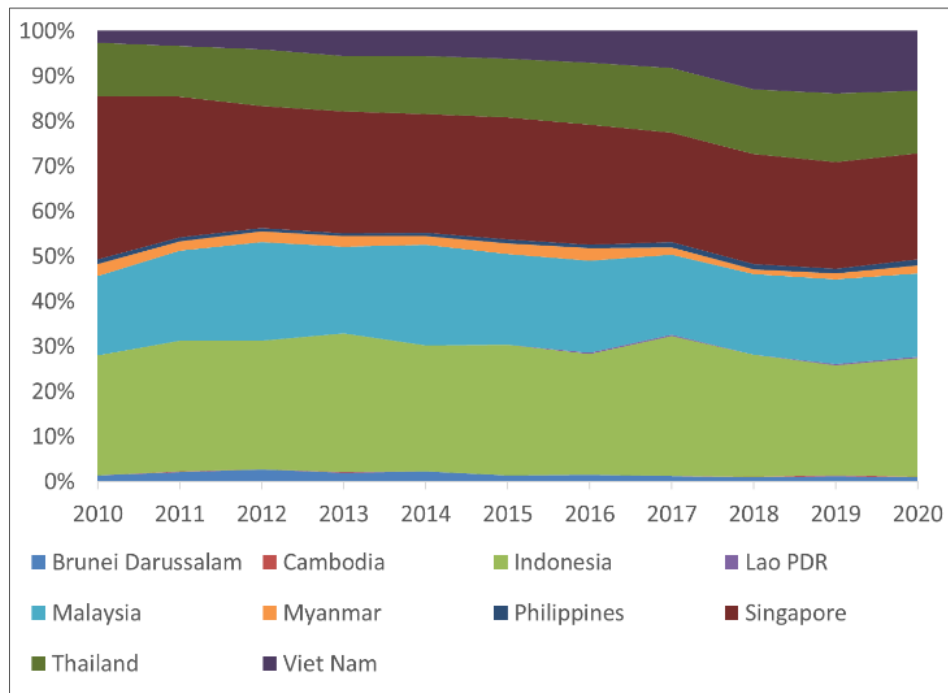
Figure 3.3 shows the share of each AMS in ASEAN's trade with India. Indonesia, Malaysia, Singapore, and Thailand have a long history trading with India. More recently, Viet Nam's share in exports to India has been rising. One possible strategy for Cambodia is to utilise the ASEAN Trade in Goods Agreement to form production networks with Viet Nam to access the Indian market indirectly. In 2019, 57% of Viet Nam's exports to India comprised machinery and electronics, a product group whose exports has been rising rapidly since 2010 at more than 8% per year. Textiles and clothing comprised 5% of Viet Nam's exports to India. Both are sectors where Cambodia can plug into the value chain with Viet Nam. Overall, Cambodia's strategy of accessing large markets could be supported by exploring

⁴ India is also a large recipient of FDI.

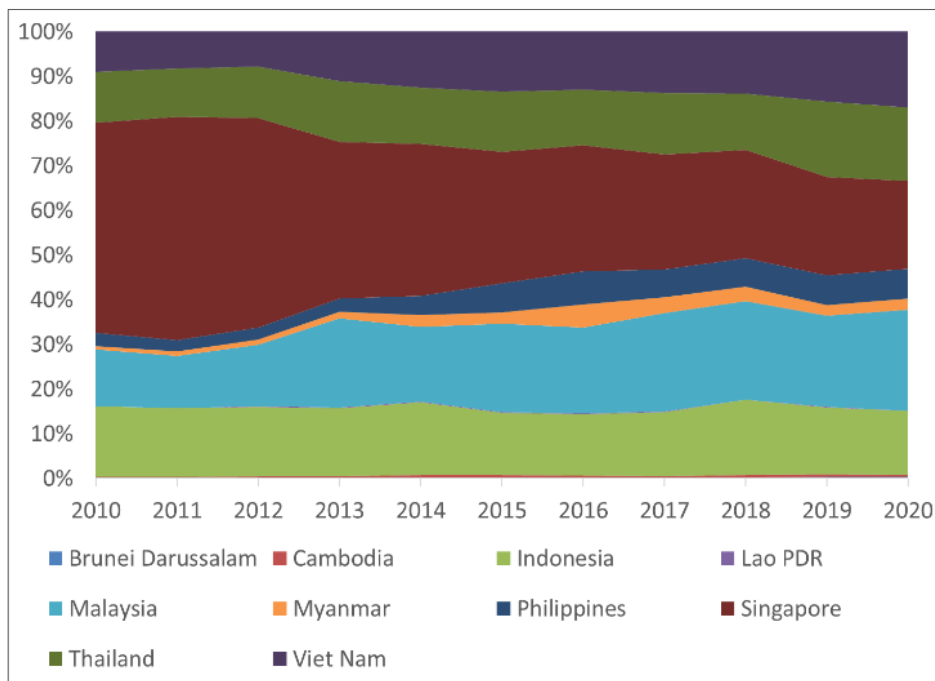
the formation of production networks within AMS that are rapidly increasing their exports to those markets.

Figure 3.3. Share of AMS in Trade with India, 2019

(a) Exports to India from ASEAN



(b) Imports from India to ASEAN



AMS = ASEAN Member States, ASEAN = Association of Southeast Asian Nations.
 Source: Authors' calculation from ASEANstats (n.d.), <https://www.aseanstats.org/> (accessed 28 March 2022).

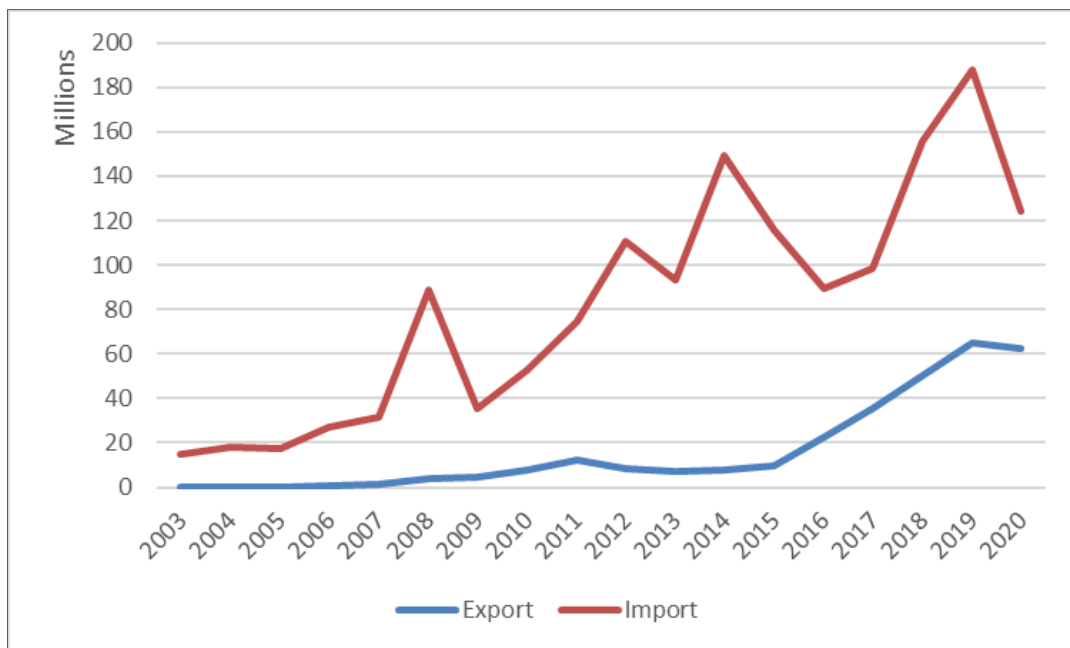
1. Existing Bilateral Relationships and Arrangements between Cambodia and India

Any bilateral FTA with India would build on existing relationships between the two countries. Cambodia–India relations date back to ancient times, when Hindu and Buddhist religious and cultural influences emanated out of India to Cambodia and parts of Southeast Asia. Cambodia and India have maintained warm and cordial political relations. India was one of the first countries to open its embassy in Phnom Penh in 1981 after the collapse of the Khmer Rouge regime. Bilateral relations have been reinforced by several high-level visits. Economic relations between Cambodia and India are facilitated by the Agricultural Industries Confederation trade in goods; trade and investment figures between both economies have reacted positively in recent years.

1.1. Trade and Investment

Trade between Cambodia and India is steadily rising. India's merchandise exports to Cambodia increased from \$7.9 million in 2000 to \$204.0 million in 2019, with a growth rate of 17.7% per year. During the same period, India's merchandise imports from Cambodia also increased significantly from \$1.3 million to \$46.6 million, with a growth rate of 33.4% per year. India is one of Cambodia's top 10 import partners. The sectors that account for the largest shares of India's exports to Cambodia are chemicals (30.0% in 2019), transport equipment (29.4%), textiles and clothing (15.9%), and machinery and electronics (7.2%). The high share of chemicals in the export basket is mainly because of pharmaceutical products. Imports of automobiles and tractors have increased rapidly in recent years in line with Cambodia's economic growth. Cambodia's share in India's imports is very small owing to the size difference, but still contributes a substantial share in certain products.

Figure 3.4. Cambodia's Merchandise Exports and Imports from India



Source: Authors' calculation from ASEANstats (n.d.), <https://www.aseanstats.org/> (accessed 28 March 2022).

However, there is little product diversity in trade between the two countries. More than 80% of Cambodia's exports to India are accounted for by 15 products; likewise, more than 70% of Cambodia's imports from India are accounted for by 15 products. Cambodia's exports to India have been mainly concentrated in textiles and clothing (22% in 2019), comprising finished apparel, and more recently in natural rubber. Comparing Cambodia's export basket to the world vis-à-vis that to India, we find that the share of vegetables (e.g. turmeric and dried fruits) and natural rubber are higher in the export basket to India. On the other hand, animal hides and skins, wood, textiles and clothing, and stone and glass are less featured in Cambodia's exports to India compared with its exports overall.

Table 3.1. Cambodia's Major Exported and Imported Products to/from India
(HS 4-digit level)

(a) Exports to India

HS code	Description	Value (US\$ 1000)
Year = 2000		
0402	Milk and cream, concentrated or containing added sugar or other sweetening matter	57.0
8528	Reception apparatus for television	31.0
5515	Other woven fabrics of synthetic staple fibres	21.8
6103	Men's or boys' suits, ensembles, jackets, blazers, trousers, etc.	16.7
8521	Video recording or reproducing apparatus	10.0
Year = 2010		
1511	Palm oil and its fractions	6,162.6
6404	Footwear with outer soles of rubber, plastic, leather, etc.	436.9
4001	Natural rubber, balata, gutta-percha, chicle, and similar natural gums	416.0
6110	Jerseys, pullovers, cardigans, waistcoats, and similar articles	199.1
1513	Coconut (copra), palm kernel, or babassu oil	117.3
Year = 2019		
4001	Natural rubber, balata, gutta-percha, guayule, chicle, and similar natural gums	27,514.1
1511	Palm oil and its fractions	5,542.7
8541	Diodes, transistors and similar semiconductor devices	4,864.1
1108	Starches; inulin	2,913.1
6109	T-shirts, singlets, and other vests	2,486.1

Table 3.1. *Continued*

(b) Imports from India

HS code	Description	Value (US\$ 1000)
Year = 2000		
3004	Medicaments (excluding goods of headings 3002, 3005, or 3006)	4,890.2
5515	Other woven fabrics of synthetic staple fibres	951.9
2402	Cigars, cheroots, cigarillos, and cigarettes	754.8
8413	Pumps for liquids, whether or not fitted with a measuring device; liquid elevators	551.3
2401	Unmanufactured tobacco; tobacco refuse	439.6
Year = 2010		
3004	Medicaments (excluding goods of headings 3002, 3005, or 3006)	18,715.8
5515	Other woven fabrics of synthetic staple fibres	9,597.7
2308	Vegetable materials and vegetable waste, vegetable residues and by-products	7,037.1
4104	Tanned or crust hides and skins of bovine or equine animals	2,177.4
5211	Woven fabrics of cotton	1,981.7
Year = 2019		
8703	Motor cars and other motor vehicles	57,408.5
3004	Medicaments (excluding goods of headings 3002, 3005, or 3006)	39,675.5
8602	Other rail locomotives; locomotive tenders	12,750.0
5515	Other woven fabrics of synthetic staple fibres	10,776.6
8701	Tractors (other than tractors of heading 8709)	9,892.7

HS = Harmonized System.

Sources: United Nations, UN Comtrade Database, <https://comtrade.un.org/> (accessed 1 August 2022); and World Bank, World Integrated Trade Solutions, <https://wits.worldbank.org/> (accessed 1 August 2022).

The Cambodia–India bilateral trade share – defined as the ratio of total trade between the two partners as a fraction of the total trade of each partner with the world – increased from 0.0002 in 2000 to 0.0007 in 2019, indicating decreasing trade costs for India–Cambodia. While the bilateral trade share for India–Cambodia trade shows a clear increase over the years, the absolute value of this indicator remains significantly lower relative to India’s bilateral trade with other major partners in Asia. This latter observation

implies that the India–Cambodia bilateral trade share could be increased by further reducing trade costs. Likewise, India–Cambodia bilateral trade intensity, which measures the degree to which two countries tend to trade with one another relative to the world, has been increasing since 2010. However, their trade intensity is the lowest amongst the various pairs, indicating significant unexploited trade potential between India and Cambodia, which may be realised by signing an FTA.

Two analyses suggest potential for further trade creation between Cambodia and India. First, the correlation between the revealed comparative advantage indices of India and Cambodia at the 6-digit HS level is very low, suggesting that the two countries show comparative advantages in different products, thus implying that an FTA could lead to trade creation. Cambodia and India have a competitive relationship in the exports of food products, with both countries exhibiting high revealed comparative advantage indices. India's export similarity index with Cambodia is very low – despite an increase from 0.04 in 2010 to 0.12 in 2019 – implying that the two countries specialise in different industries, which could lead to growth of inter-industry trade.

India's export basket also shows a relatively high degree of complementarity with Cambodia's import basket. This means that India is able to supply a larger range of products that Cambodia currently imports from other countries. However, Cambodia's export basket shows relatively low trade complementarity with India's import basket. Thus, Cambodia can only export a limited range of products that India imports from other countries. Through diversification of its export basket, Cambodia could increase its trade complementarity to capture a bigger market share in India.

There is also untapped potential for creating deeper international production linkages between the two countries. The role of India in Cambodia's top export items currently remains limited. Between 2018 and 2019, India's share averaged 0.3% of the total top 30 export items. Interestingly, imports from India accounted for around 1.0% of Cambodia's total imports, with mild declining trends. Another indicator is that India's intra-industry trade with Cambodia is very low – just 1% of total trade in 2019 – despite some increase since the mid-2010s. Overall, it can be inferred that the trade flows between India and Cambodia could be increased significantly through the channels of both inter- and intra-industry specialisation. Greater engagement in GVCs would enable both countries to exploit the trade potential through intra- and inter-industry trade, as well as through extensive and intensive margins.

Regarding bilateral investment, India is one of the top 10 foreign investors in Cambodia. India has invested \$19.8 million in total in Cambodia, with major companies like Bajaj Auto and TATA Agrico establishing subsidiaries there. From 2006 to 2018, direct investment from India to Cambodia also flowed into two services subsectors: financial services and hotels and tourism.

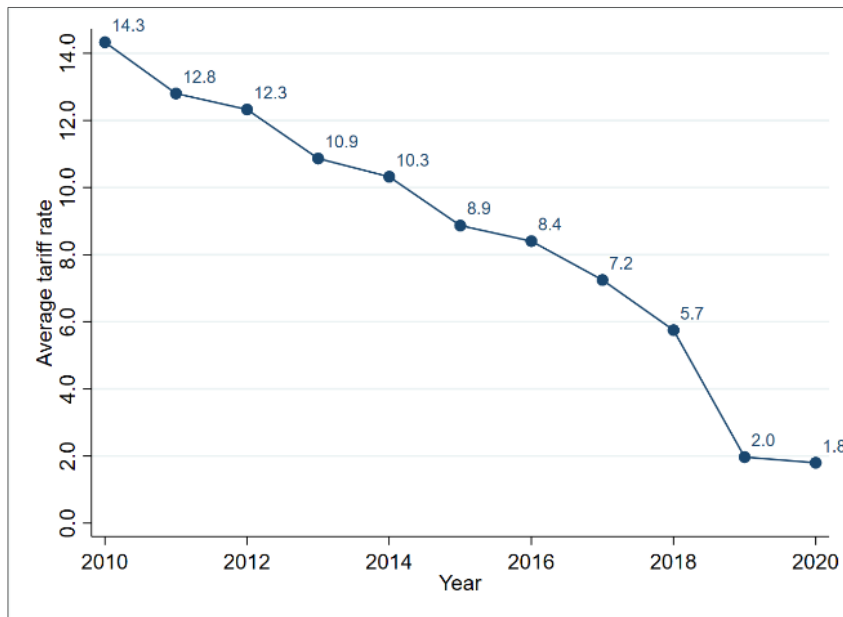
1.2. Preferential Trade Arrangements

The trade relationship between Cambodia and India is governed by multiple agreements and provisions, mostly at the ASEAN level. The AIFTA was signed and entered into force on 1 January 2010 under which AMS and India agreed to open their respective markets by progressively reducing and eliminating duties on 76.4% of goods. Product lines are classified into five categories: normal track (4,000 product lines where tariffs are eliminated), sensitive track (560 product lines where tariffs are reduced), special products (limited tariff reduction), highly sensitive list, and exclusion list. The ASEAN–India Trade in Services Agreement, signed in November 2014, contains provisions on transparency, domestic regulations, recognition, market access, national treatment, and dispute settlement. Finally, the ASEAN–India Investment Agreement, also signed in November 2014, stipulates the protection of investment to ensure fair and equitable treatment for investors, non-discriminatory treatment in expropriation or nationalisation, as well as fair compensation.

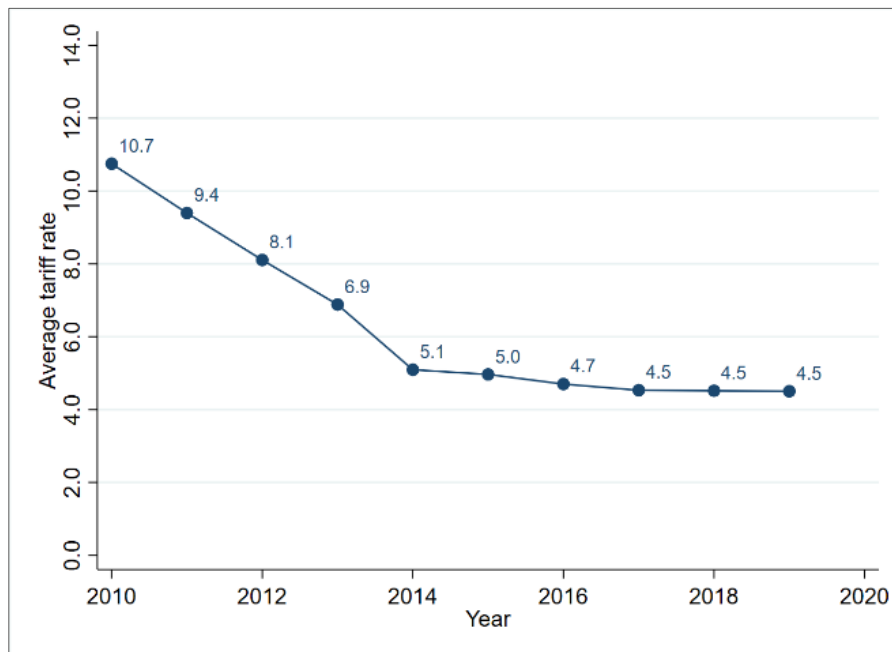
From a pre-agreement average MFN rate of 14.3% in 2017, tariffs applied by Cambodia on imports from India fell to 1.0% on average by 2021 under the AIFTA, with 80% of product lines enjoying zero tariffs. Cambodia's tariff schedule under the AIFTA has five product categories for 8,299 tariff lines at the 8-digit level. In normal track 1 and 2, with 6,644 and 336 tariff lines respectively, the average tariff rates declined from 13.3% to 0% between 2010 and 2020 for the former and from 22.8% to 8.2% for the latter. At the same time, India's average unweighted tariffs on imports from Cambodia fell from 10.7% in 2010 to 4.4% in 2019, with 75% of products with zero tariffs. India has placed several agriculture and food products on the exclusion list, which results in higher average preferential rates. Figure 3.5 shows the evolution of preferential tariffs under the AIFTA.

Figure 3.5. Tariff Reduction Schedules Under the AIFTA

(a) Cambodian Tariffs Under the AIFTA



(b) Indian Tariffs Under the AIFTA



AIFTA = ASEAN–India Free Trade Area, ASEAN = Association of Southeast Asian Nations, MFN = most favoured nation.
Source: Authors' compilation from ASEAN (2012), ASEAN–India Free Trade Area Schedule of Tariff Commitments. <https://asean.org/asean-india-free-trade-area/> (accessed 25 April 2023).

The average margin of preference offered by India to Cambodia through the AIFTA is about 7%, meaning that, on average, Cambodian exporters enjoy a 7-percentage-point lower tariff when exporting to India compared with third-country exporters. One goal of a bilateral FTA should be to increase this margin of preference so that more Cambodian exporters are encouraged to utilise the FTA.

To identify areas where a bilateral FTA with India could improve upon the AIFTA, Cambodian exports on which India imposes high tariffs under the AIFTA were assessed, and then the margin of preference currently offered under the AIFTA was reviewed. If each tariff line is weighted by its importance in Cambodia's global exports, the average tariff imposed by India is 7.4%, meaning that there are certain products with high importance on which India imposes high tariffs under the AIFTA due to high Indian tariffs on agricultural products and rubber. Furthermore, 35% of Cambodian global exports are products that have been placed on the exclusion list by India under the AIFTA. Only 5% of Cambodian global exports are in products not on the exclusion list, yet the AIFTA tariffs remain the same as the MFN rates. These products are mostly fur skins and artificial fur.

According to export statistics, Cambodia's exports to India under the AIFTA totalled about \$22 million in 2019, comprising more than 37% of Cambodia's exports to India. Increasing Cambodian exporters' ability to utilise these provisions should be an important part of Cambodia's effort to leverage international trade for economic growth.

AIFTA's utilisation rate, which determines the extent to which an FTA leads to trade creation, is still very low at below 3%. Looking across HS chapters, the utilisation rate is above 10% in only a handful of products: HS 11, 19, 20, 48, and 87. The utilisation rate of the AIFTA by importers in Cambodia is still very low in many sectors, possibly due to the exemption of import duties for export-processing firms, which import intermediate materials for producing exported products, such as apparel. However, several product lines have low utilisation rates, although the exemption is not applied. The rate has slowly increased in intermediate goods for domestic production and consumption in recent years, but could be increased further by developing the domestic industrial structure and expanding domestic consumption. To facilitate the use of FTAs, their costs must be reduced and their benefits raised, and the large preferential tariff margin is a significant factor in raising the benefits. Substantial and prompt tariff reduction/elimination under FTAs is necessary to improve the positive effect of an FTA. India also offers Cambodia preference under the Duty-Free Tariff Preference (DFTP) scheme, which provides zero duty and preferential market access to LDCs including Cambodia on more than 98% of India's tariff lines. But its utilisation rate is also very low.

There is a small positive impact of the AIFTA on trade with India in terms of both trade value and variety. The AIFTA does not have a high positive effect in many sectors, however. Exports in clothing and footwear, machinery, and transport equipment could be increased. Cambodia–India trade is moving closer to the predicted trade from the gravity model, but there is room for greater gains.

The Cambodia–India trade and investment relationships could be improved through bilateral FTAs if such agreements addressed the remaining barriers and bottlenecks, such as tariffs, rules-of-origin provisions and related documentary requirements, non-tariff measures (NTMs), trade in services, investment, logistics, and trade facilitation.

Chapter 4

Trade and Investment Environment in India

An understanding of the trade and investment environment in a potential FTA partner is necessary to foster fruitful dialogue with the partner and ensure that benefits from future FTAs are maximised.

Compared with Cambodia, India has a more restrictive trade policy and a greater degree of protection towards its agricultural sector. India's simple average MFN tariff declined significantly from about 33.0% in 2000 to 12.0% in 2010 and then increased gradually to 15.4% in 2019. While India's MFN tariff has increased since the late 2000s, the effectively applied rate (AHS) has not shown a noticeable increase during this period. Tariff reduction has been mainly focused on the manufacturing sector, while the average MFN and AHS tariffs remain high for agricultural products. As most agricultural products have been kept out of the scope of preferential trade agreements, the applied tariff rate is not significantly different from the MFN rate for India's agriculture products. The bound tariff rate for India's agriculture products remains high, at more than 100%. Table 4.1 compares India's MFN tariffs with the schedule in the AIFTA. India already provides substantial concessions in many products, except animal and vegetable, food, and transport products. An FTA between Cambodia and India could make India's agricultural market more accessible to Cambodian products.

Table 4.1. India Tariff Rates by Sector and Trade Partner/Preferential Trade Agreement, 2020

HS Group (Chapter)	MFN	AIFTA
Animal and vegetable (01–15)	33.7	18.2
Food products (16–24)	48.1	34.4
Minerals and fuels (25–27)	5.8	1.8
Chemicals (28–38)	8.6	1.4
Plastic, rubber, hides, and skins (39–43)	10.2	4.0
Wood (44–49)	9.0	0.3
Textiles and clothes (50–63)	14.4	1.8
Footwear (64–67)	18.7	3.6
Stones, glass, metals (68–83)	9.6	0.3
Machinery and electronics (84–85)	7.8	0.8
Transport (86–89)	44.4	33.5
Miscellaneous (90–96)	11.2	0.6

AIFTA = ASEAN–India Free Trade Area, ASEAN = Association of Southeast Asian Nations, HS = Harmonized System, MFN = most favoured nation.

Source: Authors' calculation from World Integrated Trade Solution data (<https://wits.worldbank.org/> [Accessed 7 June 2021]).

India's trade liberalisation has proceeded, with several bilateral and regional FTAs. India has notified 16 trade agreements to the WTO, including bilateral agreements with four AMS (i.e. Malaysia, the Philippines, Singapore, and Thailand). Negotiations with trading partners are progressing, including Australia, Bangladesh, Canada, the EU, the European Free Trade Association, the Gulf Cooperation Council, Indonesia, Iran, Israel, Mauritius, New Zealand, Peru, the Southern African Customs Union, and the Bay of Bengal Initiative on Multi-Sectoral Technical and Economic Cooperation. Table 4.2 lists India's trade agreements with East Asian countries. During a brainstorming session convened by the Economic Research Institute for ASEAN and East Asia (ERIA), experts noted that India is expanding efforts to open up trade and pursue further engagement in the GVC, especially in the assembly of parts and components.

Of particular relevance are India's bilateral agreements with the four AMS, which have enhanced the liberalisation achieved under the AFTA, such as slightly higher tariff preferences for a limited number of products. For example, under the Comprehensive Economic Cooperation Agreement with Malaysia signed in 2011, India offered ASEAN+ tariff concessions on 76 items, giving access to products such as fruits, cocoa, and synthetic textiles. Malaysia offered similar tariff concessions to India on 140 items, including basmati rice, mangoes, eggs, trucks, motorcycles, and cotton garments. In the automotive sector, India received non-reciprocal market access for motorcycles up to 150 cc and trucks, including dump trucks, for the first time under any FTA. While India's bilateral agreements with individual AMS have not led to further tariff reductions for goods – compared with tariffs with ASEAN as a whole – the Comprehensive Economic Cooperation Agreement's objective is to deepen integration, not only for goods but also services, investment, trade facilitation, customs cooperation, investment, competition, government procurement, and intellectual property rights.

In addition to preference on a bilateral or regional basis, following the WTO Hong Kong Ministerial Declaration of 2005, India granted the DFTP scheme to all LDCs in August 2008. At present, 29 LDCs, including Cambodia, benefit from this scheme.

Table 4.2. India's Trade Agreements with East Asia

Country/Bloc	Type of agreement	Current status
Thailand	CECA	2004 in force, under negotiation
ASEAN (Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, Viet Nam)	FTA	2010 in force, further negotiation
Singapore	CECA	2005 in force, under negotiation
Indonesia	CECA	1968 in force, under renegotiation
Malaysia	CECA	2011 in force
Japan	FTA	2011 in force
Republic of Korea	CECA	2010 in force
APTA (Bangladesh, China, India, Republic of Korea, Sri Lanka)	PTA	2014 in force

APTA = Asia Pacific Trade Agreement, ASEAN = Association of Southeast Asian Nations, CECA = Comprehensive Economic Cooperation Agreement, PTA = preferential trade agreement, FTA = free trade agreement.

Source: Trade Promotion Council of India (n.d.), Trade Agreements – The Indian Perspective. https://www.tpci.in/indiabusinessstrade/research_report/trade-agreements-involving-india/

Regarding restrictions on services in India, 'restrictions on foreign entry' constitute the major restrictions for all sectors except one: sound recording. For a subset of sectors – accounting, architecture, engineering, legal, maritime, and road freight transport – restrictions on the movement of people is the second-most important component. Restrictions on the movement of people is significant also for computer services and rail freight transport. For another subset of sectors – air transport, courier services, distribution services, insurance, rail freight transport, logistical cargo handling, and telecommunications – barriers to competition are the second-most important component of restrictions. Issues related to regulatory transparency act as an important barrier in sectors such as commercial banking, computer services, courier services, logistical cargo handling, logistical customs brokerage, logistical freight forwarding, logistical storage and warehouses, rail freight transport, and sound recording.

Some recent reforms undertaken by India in the services sectors include (i) easing foreign equity limits from 26% to 49% in the insurance sector in 2015; (ii) allowing foreign branches into the reinsurance business in 2015; (iii) removing foreign equity limits on airport services and cable and satellite broadcasting in 2016; (iv) easing foreign equity limits in civil aviation in 2016; (v) eliminating minimum capital requirements for establishing a company in most sectors in 2016; (vi) lifting several restrictions on cabotage in maritime transport in 2018; (vii) permitting 100% foreign equity in coal-mining activities in 2019; (viii) further opening up the defence sector in 2020 to allow 74% foreign equity; and (ix) allowing non-resident Indians to acquire up to a 100% stake in Air India in 2020. However, India introduced an equalisation levy of 6% on purchases of advertising services from non-resident companies in 2017. Since 2018, all payment system operators in India are also required to ensure that data related to payment systems operated by them are only stored inside the country.

India provides preferential treatment to services and service suppliers of LDCs through waivers of visa fees as well as duty-free and quota-free treatment. Under this waiver, visa fees are waived for LDC applicants seeking Indian business and employment visas, technical assistance and capacity building, and market access in various sectors and sub-sectors as well as access for several categories for professionals from LDCs. Notably, India is the only WTO member that offers to waive visa fees for LDC applicants.

Chapter 5

Potential Impact of Bilateral FTAs

Before embarking on an FTA, it is important to develop an understanding of its potential impact. The most visible consequence of successful FTA negotiations is the reduction and/or elimination of tariffs on imports from the FTA partner, thus creating a margin of preference vis-à-vis the MFN tariffs applied to all countries. FTAs generally aim for zero tariffs on all product lines and may also include agreements on behind-the-border issues such as NTMs, trade facilitation, services, investments, and others. The benefits of FTAs arise from reductions in the cost of bilateral trade, but also involve structural adjustments in production and consumption. Much also depends on the status of the bilateral trading environment and the potential to form new supply chains.

ERIA conducted quantitative and qualitative analyses to understand the potential impact of a Cambodia–India FTA using standard approaches that are widely applied in analysis of FTAs. A simulation exercise using the Global Trade Analysis Project modelling, commonly applied to understand the overall impact of an FTA under various hypothetical scenarios, shows that there would be positive gains for both Cambodia and India, with Cambodia experiencing slightly higher gains. These gains come through boosts in exports, investment, and consumption due to lower tariffs. The relatively higher gains for Cambodia are attributed to the reduction of higher tariffs on Cambodia's products entering India, whereas Cambodia's tariffs on India's products are already very low. In addition to tariff elimination, further gains could be achieved if the FTA were to minimise barrier effects of NTMs, incorporate trade facilitation measures, use simplified ROOs, and cover the services sector.

The impact of trade liberalisation on employment is a major concern for policymakers. Despite the popular concern that tariff liberalisation may reduce employment through intensified import competition, our analysis finds little evidence that tariff liberalisation had an impact on domestic employment. Table 5.1 shows the employment structure of Cambodia's manufacturing sector. Close to one-third of manufacturing employment is generated in the wearing apparel sector, and another one-third in the beverage industry (although its share is declining over time). Wood products, tobacco, and furniture are other significant employment creating sectors. These sectors are likely to be impacted by trade liberalisation, with some sectors expanding and others contracting, depending on technology.

Employment effects of the AIFTA on Cambodia were small. The main findings from the household analyses indicate that tariff liberalisation in the AIFTA showed little significant impact on wage payments and household expenditures – even during a longer period from 2009 to 2019. There are many possible reasons for finding a minimal effect. First, the results are consistent with the impression of less competition and more

complementarity in Cambodia–India trade. However, India’s import penetration so far has been very small. Imports of manufactured goods from India to Cambodia have increased from \$16.9 million in 2010 to \$72.8 million in 2014, much smaller than the \$200.0 million observed in 2019. This is likely to increase further going forward. The impact of a bilateral FTA, which may lead to much larger import penetration, could be larger. Social policies would be needed to mitigate any potential negative impacts of the FTA as the economy adjusts to a new allocation of resources. Supportive policies to help worker reallocation are also needed in case of a large disruption to the economy.

Table 5.1. Share of Sample Workers in CSES Data Sets
(%)

Manufacturing Sector	2009	2014	2019/20
Food	1.9	2.1	1.9
Beverages	45.2	41.1	35.2
Tobacco	2.0	2.8	6.6
Textiles	1.1	0.9	1.8
Wearing apparel	25.6	31.4	30.3
Leather	0.3	1.2	2.5
Wood products	10.6	10.6	10.3
Paper	0.1	0.2	0.1
Printing of recorded media	0.1	0.1	0.1
Coke/refined petroleum products	0.0	0.0	0.0
Chemicals	0.1	0.1	0.2
Pharmaceutical products	0.0	0.0	0.0
Rubber and plastics products	5.4	2.0	1.5
Non-metallic mineral products	1.0	1.3	1.6
Basic metals	0.1	0.0	0.1
Fabricated metal products	0.4	1.0	2.0
Electronic products	0.0	0.1	0.1
Electrical equipment	0.0	0.1	0.2
Machinery	0.0	0.0	0.0
Motor vehicles	0.0	0.0	0.0
Other transport equipment	0.0	0.0	0.0
Furniture	5.6	4.7	4.7
Other manufacturing	0.3	0.4	0.6

CSES = Cambodian Socio-Economic Survey data.

Source: Authors’ calculations from Cambodian socio-economic survey data

(<https://www.nis.gov.kh/index.php/km/14-cses/12-cambodia-socio-economic-survey-reports>).

References

- Chipman Koty, A. (2022), 'Cambodia's Law on Investment: What Foreign Investors Need to Know', *ASEAN Briefing*, 16 June. <https://www.aseanbriefing.com/news/cambodias-law-on-investment-what-foreign-investors-need-to-know/#:~:text=In%20late%202021%2C%20Cambodia%20introduced,exemption%20and%20customs%20duties%20incentives>
- Khmer Times* (2020), 'Cambodia Has 54 Special Economic Zones, More to Come', 1 February. <https://www.khmertimeskh.com/686294/cambodia-has-54-special-economic-zones-more-to-come/>
- Kingdom of Cambodia (2019), 'Cambodia Trade Integration Strategy 2019–2023,' July. <https://cambodiancorner.files.wordpress.com/2019/12/cambodia-trade-integration-strategy-2019-2023-1.pdf>.