

Cambodia: Challenges and Options of Regional Economic Integration

Conference Papers

**Chan Sophal, Toshiyasu Kato & Long Vou Piseth
Jeffrey Kaplan
Kun Nhem
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CAMBODIA DEVELOPMENT RESOURCE INSTITUTE



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October 1998**

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Foreword

Cambodia's membership in the Association of Southeast Asian Nations has been attracting keen interest since its official application to become a full member in April 1996. What impact will membership have on Cambodia's economy? What challenges will it pose to policy-making in Cambodia? What options does the Cambodian government have to meet those challenges? These questions are timely and relevant, and yet little substantial research has been undertaken to answer them. There has been a feeling since the application that more information would need to be generated to ground public debate and policy-making on solid economic research and empirical evidence.

It was in this regard that the Cambodia Development Resource Institute launched a research project on Cambodia's regional integration in January 1997. As an integral part of the project, CDRI held an international conference on 27 and 28 October 1997 in Phnom Penh. The conference created a forum for discussion concerning Cambodia's membership in ASEAN, and particularly the economic implications of the ASEAN Free Trade Area. The conference gathered many participants from government, research institutes, multilateral and bilateral donor agencies and NGOs in Cambodia.

The current volume is a collection of the five research papers on Cambodia presented at the conference. These papers were written by experts who had been undertaking research and/or who were involved in policy-making regarding ASEAN issues in Cambodia. These proceedings cover a broad range of issues, from legal and institutional aspects to macro-economic management and fiscal policy, trade and industrial policies, and sustainable development. The discussions in the volume are also illuminated and deepened by the opening speech of H.E. Keat Chhon, Senior Minister in Charge of Rehabilitation and Development and Minister of Economy and Finance, and a special guest lecture delivered at the end of the conference by H.E. Cham Prasidh, Minister of Commerce.

Cambodia's membership in ASEAN was indefinitely postponed after the fighting of 5 and 6 July 1997. There are some indications to believe, however, that both ASEAN and Cambodia are committed to realising the ASEAN-10, with the inclusion of Cambodia, towards the end 1998. It is a great pleasure to offer these conference proceedings to the public at this juncture. We hope that the current volume will contribute to accumulating knowledge and information, encouraging policy discussions and debate, and stimulating future research regarding Cambodia's economic integration with ASEAN and the world economy.

*Eva Mysliwicz, Director
September 1998*



Glossary

Acronyms

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
AIA	ASEAN Investment Area
AICO	ASEAN Industrial Cooperation
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
CEPT	Common Effective Preferential Tariffs
CDC	Council for the Development of Cambodia
CIB	Cambodia Investment Board
EC	European Community
ETR	effective trade tax rate
EU	European Union
FAO	Food and Agriculture Organisation
FDI	foreign direct investment
FTA	free trade area
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNP	gross national product
GSP	generalised system of preferences
HIV	human immuno-deficiency virus
HS	Harmonised System
ICN	Internal Coordination Network
IMF	International Monetary Fund
MFN	most favoured nation
MoU	memorandum of understanding
NAFTA	North American Free Trade Area
NBC	National Bank of Cambodia
NBER	National Bureau of Economic Research
NGO	non-governmental organisation
NIS	National Institute of Statistics
NT	national treatment
PTA	preferential trade arrangement
RCA	revealed comparative advantage
RCAX	revealed comparative advantage of exports
RGC	Royal Government of Cambodia
SEATE	Southeast Asian transitional economy

SITC	Standard International Trade Classification
SME	small- and medium-sized enterprise
UAP	unprocessed agricultural product
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNFPA	United Nations Population Fund
UNRISD	United Nations Research Institute for Social Development
UNTAC	United Nations Transitional Authority in Cambodia
VAT	value-added tax
WTO	World Trade Organisation

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This collection of conference papers would not have been realised without useful advice and assistance of numerous people at various stages of our regional integration project.

At the early stages, while identifying key issues and potential contributors to our international conference, we received useful suggestions and advice from Dr Aun Porn Moniroth at the Ministry of Economy and Finance. We appreciated his recommendation of Dr Kun Nhem from the Ministry of Economy and Finance, who offered an informative paper at the conference. We also learned a great deal from Dr Aun's research papers and articles on Cambodia's membership in ASEAN, some of which were co-authored with H.E. Keat Chhon. We also wish to thank Mr Kao Kim Hourn at the Cambodian Institute for Cooperation and Peace, who helped us at various stages of the project. It should be acknowledged that he and his Institute have played, and continue to play, a leading role in the research of ASEAN and regional issues in Cambodia. Mr Jeffrey Kaplan at UNDP-Cambodia not only contributed an important paper to this volume, but also helped us to identify key conference participants. We also thank Mr Roger Lawrence at the Ministry of Commerce, who recommended a distinguished work from Mr James Robertson and Mr Harold Pohoresky on trade and investment policies for the conference.

We wish to express our special gratitude to Mr Sok Siphana, Dr Hing Thoraxy, Mr Vongsey Vissoth and Mr Chap Sotharith, who kindly accepted our request to chair several discussion sessions at the conference. We also wish to thank the international contributors from Laos, Vietnam and Japan, who shared with us their views of ASEAN issues: Dr Jayant Menon at Monash University, Australia; Mr Somchith Inthamith at the Ministry of Commerce in Laos; Dr Nguyen Xuan Nguyen and Mr Hoang Van Thanh from the Central Institute of Economic Management in Vietnam; and Mr Shigeru Itoga from the Institute of Developing Economies in Japan. (Copies of the papers of the international contributors to the conference are available from CDRI's Publication Programme for a nominal charge.)

We owe a great deal to our colleagues at CDRI. We wish to acknowledge and thank Dr K. P. Kannan, former research coordinator, who initiated and set the overall tone of our project. We also benefited greatly from frequent conversations with our fellow economists, Dr K. A. S. Murshid and Ms Carol Litwin. Administrative and information technology staff, Ms Mom Sokhayouk, Ms Oeung Bon Thyda, Ms Kol Nou Sorya, Mr Em Sorany and Mr Leng Vanna, provided us with excellent support to organise and prepare for the conference. Mr Michael Wills in the Publications Programme has efficiently carried out the work of coordinating, editing and producing these conference proceedings for publication.

Last, but not least, we thank Ms Eva Mysliwicz, director of CDRI, who oversaw our project with tireless support and encouragement.

*Toshiyasu Kato, Research Fellow
Long Vou Piseth, Researcher
Chan Sopha, Researcher
September 1998*

Opening Remarks

H.E. Keat Chhon¹

Excellencies, Ladies and Gentlemen,

I would like to begin by thanking the organiser of this forum, the Cambodia Development Resource Institute, for inviting me to join this conference on *Challenges and Options of Regional Economic Integration: A Study on Cambodia's Membership in ASEAN*.

Regional Economic Integration

As I have stated on many occasions, there is no doubt that regional economic integration is critical for Southeast Asia, and ASEAN economic cooperation is the dynamic driving force in this effort. Initiatives such as the ASEAN Free Trade AREA (AFTA), the ASEAN Industrial Cooperation (AICO) scheme and the ASEAN Investment Area (AIA) are vehicles for regional integration, but in the end it will be the efforts of the private sector that will determine the ultimate success or failure of such integration.

Cambodia cannot ignore the trend towards regional integration. Any discussion of ASEAN membership must be seen in this context. The region is integrating, and ASEAN is the main force behind this trend. Cambodia's economic future cannot be isolated from the region around us. These are the economic-driven phenomena. For this reason, Cambodia's eventual membership of ASEAN is unquestionable. Despite the delay in our membership, Cambodia remains determined to join ASEAN as soon as possible. Given this, it is essential that both Cambodian officials and the Cambodian people begin to understand ASEAN economic cooperation and to prepare to participate in it.

In this context, we should use the extra time created by the delay in our entry effectively to make sure that Cambodia is better prepared for ASEAN membership. That time should not be wasted. We should treat this additional time as an opportunity to further prepare for ASEAN, especially our participation in ASEAN economic initiatives such as AFTA, AICO, and cooperation in services and the AIA. It also gives us time to further strengthen our economic fundamentals and build up our institutions.

¹ H.E. Keat Chhon is Senior Minister on Charge of Economic Rehabilitation and Development and Minister of Economy and Finance. These opening remarks were delivered during his inaugural address at the *Cambodia: Challenges and Options of Regional Economic Integration* conference on 27 October 1997.

Macro-Economic Management

In order to fully appreciate the challenges of regional integration for Cambodia, it is important to first have an overview of the current Cambodian economic environment. In general, macro-economic performance was broadly satisfactory during the first half of 1997. During that period, inflation and the exchange rate were kept under control. However, over the last two to three months, we have experienced fluctuation in inflation and some depreciation of the Cambodian riel *vis-à-vis* the US dollar. Despite recent problems, we continue our efforts to carry out reforms to enhance and strengthen the environment for private sector investment and growth. In this regard, we expect the sub-decree on investment to be finalised soon, and reforms within the Council for the Development of Cambodia are being actively pursued.

With respect to public finance, since the beginning of 1997 budget implementation was tight both for revenue collection and public expenditures. While experiencing revenue decreases, especially in customs, pressure on the expenditure side remained high. In this context, the government's priorities remain paying salaries on time, safeguarding counterpart funds for development projects and conserving resources for certain urgent needs. At the same time, we are strictly controlling operational expenses of the government. The government will also continue to make every effort to improve and fully implement all revenue collection measures provided in the 1997 Finance Law and the Law on Taxation enacted by the National Assembly at the start of the year.

Continued Preparations for ASEAN

As mentioned earlier, Cambodia's commitment to ASEAN membership remains firm. And we continue with preparations, especially for AFTA. Officials are compiling the lists of products for the various AFTA/CEPT lists. The CEPT inclusion list that Cambodia will submit upon entry will demonstrate our strong commitment to AFTA and its tariff reduction aims. It will represent a significant proportion of the tariff lines used in Cambodia, around 50 percent of the total tariff lines, and will include an aggressive tariff reduction schedule.

We are taking stock of the non-tariff barriers that exist in Cambodia to notify ASEAN and create a plan for their removal. We are also seeking to gain a better understanding of the implications of AFTA for our economy, especially on key sectors such as agriculture, the informal sectors, and small and medium-sized businesses.

Informal working groups have been meeting to address ASEAN cooperation on services and tariff nomenclature. We are actively participating in discussions on the establishment of the AIA, which will make the ASEAN region—and Cambodia—an even more attractive place for investment by eliminating impediments to cross-border investment. With our far-sighted investment law that is based on an open, non-discriminatory investment regime and a very generous incentive package, Cambodia is well placed in the AIA and we expect to be able to attract significant investment in the coming years.

Challenges for ASEAN Integration

Of course, ASEAN integration represents a challenge for Cambodia. There will be short-term costs and difficulties adjusting to ASEAN. But, as I have said before, these costs should be seen as our down-payment on the economic development that will eventually follow. Still, there are critical concerns that should be eliminated.

Without question, the number one challenge for Cambodia is to develop our human resources. The need to strengthen our skills and build up our experience is well known and critical. Human resources are the key to competing economically with our ASEAN neighbours and the world.

The second big challenge of ASEAN membership is the financial burden of membership. For example, the costs of attending the 300 or so ASEAN meetings each year and supporting the various ASEAN departments within the government are significant. There is also the related question of the revenue impact of joining ASEAN's economic initiatives, particularly AFTA. We are obviously concerned with the potential revenue impact of AFTA, especially in the short to medium term. However, this issue can be managed with proper policies. Tax reform to broaden Cambodia's tax base and improve the efficiency of tax administration is crucial. Joining AFTA will push us to speed up our efforts in this regard.

A fourth concern regarding ASEAN is the potential impact on our balance of payments. To be frank, we are not certain what the balance of payments impact of AFTA, for example, will be. However, the current currency crisis facing a number of ASEAN countries should serve as a warning that this issue should not be ignored.

Lastly, we must remember that our concerns related to AFTA go beyond only the revenue question. Of course AFTA's impact on revenues is an important factor. However, given the role that informal businesses, agriculture, and small and medium-sized enterprises play in the Cambodian economy, we need to study the possible impact of AFTA on them as part of our AFTA planning. Also, issues related to non-tariff barriers—which must be removed under AFTA—and AFTA's impact on employment, must be considered. I mention these issues mainly to identify important gaps in our understanding of AFTA and its potential impact on our economy. It would be irresponsible for policy-makers to ignore these issues while moving ahead with Cambodia's preparations for AFTA.

Concerning the challenges of ASEAN economic cooperation for Cambodia, I will leave you with one final question in the minds of many people: Will investment increase in Cambodia as a result of our participation in AFTA? Increased investment is the major reason given for AFTA's importance, both by ASEAN and Cambodia. The link between trade and investment is also the reason why ASEAN is now focusing on completing the AIA. The AIA is the logical continuation of AFTA. Although AFTA can be a positive influence on investment, there is little doubt that domestic policies and a stable environment—political, security, macro-economic and legal—are the most essential factors. We need a liberal, transparent, non-discriminatory investment environment in order to compete for investment. Yet, the key factors for sustainable growth will remain our long-term stability and structural reforms. In this context, we should view our participation in ASEAN economic initiatives as an additional component of our development strategy.

Long-Term Tasks for ASEAN Integration

Thus, we must continue to liberalise and institutionalise our economy, both in terms of legal and organisational arrangements. In particular, we must improve the transparency and consistency of all our decision-making processes in government. As public servants, we need better communication and coordination among government institutions. Effective participation in ASEAN requires close cooperation among ministries to ensure that we develop clear, consistent and comprehensive policies towards ASEAN. To do this, the government will need new institutional mechanisms to address ASEAN economic cooperation and domestic economic reform.

Conclusion

In conclusion, I would like to stress that regional integration—especially ASEAN integration—is part of our balanced approach to Cambodia's long-term development. ASEAN membership and its economic cooperation can be valuable factors in Cambodia's development, along with our participation in other equally important initiatives such as the World Trade Organisation. Although AFTA will improve access to ASEAN markets, Cambodia already

has excellent access to world markets through GSP and MFN programmes. Entry into the WTO will give Cambodia access on MFN terms to the largest market of all.

We hope that AFTA will enhance ASEAN investment in Cambodia, and we certainly welcome this, provided such investment does not merely represent a shifting of old technologies and environmentally unsustainable or unsound activities to Cambodia. ASEAN's contribution to Cambodia's development will ultimately be measured by its usefulness in diversifying our economy, promoting long-term industrial growth and expanding employment opportunities to reduce poverty in Cambodia. If we are successful, Cambodia will develop into a driving force in ASEAN, a source of energy and ideas, a home for long-term investment and an example of the power of the people to build a prosperous future for themselves.

Thank you.

Closing Lecture

H.E. Cham Prasidh¹

At the outset, I would like to commend the Cambodia Development Resource Institute for sponsoring this international workshop on *Cambodia: Challenges and Options of Regional Economic Integration*, which relates to our integration into ASEAN. I have followed the comments and facts provided by the various panellists during yesterday's and this morning's meetings. I must admit that these are the most valuable documents ever published on the issue of our accession into ASEAN. The experiences of Laos and Vietnam shared during this workshop will be relayed to my colleagues in the government, and I can assure you that they have highlighted a lot of my thoughts and issues that we have not listed before. But before I turn to make some comments on those panellists' views, I would like first to share with you my perception of this issue of regional economic integration.

The integration of Cambodia into the regional and world economies is the single most important issue facing Cambodia today. Our economic future depends on our managing this integration successfully.

Our title refers to "challenges and options." Let me say at the outset that, as regards integration itself, there are no options. Integration is a must. Of course there are options as regards to how to do this, and the challenge for Cambodia is to find those options that maximise the role that integration can play in fostering faster growth and development in Cambodia.

How can we identify the options for integration that will be of most benefit to Cambodia? First, we must understand thoroughly the regional and global economies into which we are integrating. Second, we must understand our own development objectives for the next decade.

The world and regional economies are characterised by three dominant features:

- The constant lowering everywhere of barriers to trade;
- The growing role of international and regional rules and disciplines (ASEAN and WTO);
- The globalisation of production, which links trade and investment.

Cambodia's development objectives have been stated very clearly in numerous development strategy documents. The primary objective of the government is to generate new employment opportunities in order to minimise the incidence of poverty.

¹ H.E. Cham Prasidh is Minister of Commerce. This closing lecture was delivered at the *Cambodia: Challenges and Options of Regional Economic Integration* conference on 28 October 1997.

So, the challenge is clear: How to reduce poverty in Cambodia while integrating into a liberal and globalising world economy in which policies are increasingly being subjected to internationally-agreed rules of behaviour?

The link between poverty reduction and integration is growth. Growth will not solve all the problems of poverty, but without it there is no way to master poverty.

How can we ensure that integration leads to growth? There are two broad areas for policy action. First, since growth is produced by private enterprise, we must ensure that Cambodia has an environment that is favourable to sound business activity. Second, we must be sure that Cambodian businesses have an opportunity to benefit from the possibility of doing business abroad; in brief, we must negotiate market access.

There are three essential ingredients to a good business environment:

- Political stability;
- Macro-economic stability;
- A sound, predictable and transparent legal framework for business activity.

Clearly, Cambodia has not done enough in any of these areas, even though we have some remarkable achievements to our credit. Constant effort with regard to all three ingredients is required.

Negotiating market access has been a continuing activity of the Ministry of Commerce. You all know that we have secured unconditional and permanent MFN status with both the United States and the European Union, the two largest markets in the world. We have now negotiated GSP arrangements with all countries offering such arrangements, including again, most importantly, the United States and the European Union. Moreover, these efforts are now going beyond bilateral agreements. You know that Cambodia will soon join ASEAN and AFTA, and I know that this conference has addressed a number of issues associated with membership. But you may not know that we are accelerating our efforts to join the World Trade Organisation. Membership in this organisation will have a number of advantages, not least of which is automatic and enforceable MFN status with all WTO members.

How can a favourable business environment and market access be translated into growth? Here the key is exports, and investment-related exports.

Cambodia needs to look at exports as a key ingredient of its industrial development. Why exports? Simply because the demand is there: production for export is limited only by the capacities of Cambodians to produce what foreign markets want. Consequently, as our experience with the garment industry has shown, exports can generate a rapid expansion of output and employment. It is significant that at present capacity, the garment industry pays out between \$1 million and \$2 million a month in salaries, almost all of which goes to Cambodians at the lower end of the income scale.

Will Cambodians really be able to compete successfully in world and regional markets? Certainly this is a big challenge. But there are many opportunities. We must grasp the opportunities that arise from one of the key characteristics of the world economy that I mentioned earlier: the globalisation of production. There are investors who would be prepared to invest in Cambodia's export capacity, and who have the production and marketing experience necessary to ensure that the resulting production will be marketed abroad. So we need to encourage foreign investment for export. In Cambodia, investment and trade are closely related.

Against this background, let me address in some detail issues that arise with regard to joining ASEAN, and in particular AFTA:

- The regional ASEAN economies have an impressive record of rapid growth. Some are now encountering difficulties, but these can be expected to be short-lived. As a result of

this rapid growth, they have experienced upward pressure on wages, and some industries are losing their competitiveness.

- Cambodia offers a low-wage environment that could be used by producers in other ASEAN countries as a production base for re-locating industries that are losing competitiveness.
- How can Cambodia play this role? A first condition is that Cambodian exporters should have access to the other regional AFTA markets at the CEPT tariff rate.
- By January 1998, the regional AFTA members will have moved all the tariff rates on their inclusion lists to 20 percent or less.
- According to AFTA provisions, exporters in Cambodia will be entitled to the CEPT rate in those member countries only if Cambodia's own tariff rate on imports of the product in question are less than 20 percent.
- It follows that, if we want to be the preferred location for investment from other AFTA countries, there are two things we must do: 1) we must put as many tariff lines as possible on the inclusion list; and 2) we must immediately lower tariffs that are above 20 percent to 20 percent or less.

Will our difficult budget situation allow such tariff cuts? Senior Minister Keat Chhon and Dr Kun Nhem from the Ministry of Economy and Finance have already addressed this issue. I would just list some observations:

- Most tariff revenue originates from a few tariff lines. These should be kept off the inclusion list (and put on the temporary exclusion list).
- Most of the tariff lines that produce revenue involve imports of things like cigarettes, beer and automobiles, that are in most countries subject to consumption taxes. This should also be done in Cambodia, so that import duties can eventually be reduced without any loss in revenue from the overall taxation of the product in question.
- Efforts to broaden the tax base should be accelerated. The role of customs duties in overall budget revenue is too high, and prevents the use of tariffs for fostering growth and development.

Let me now highlight the viewpoints of some of our panellists.

Reference to Dr Toshiyasu Kato's Presentation

The above analysis seems to suggest that regional economic integration will pose enormous challenges to the agricultural sector in Cambodia. The agricultural sector in Cambodia has not yet gathered momentum to reveal its potential comparative advantage within the ASEAN region. It will be exposed to stiff competition with the regional economies, where farmers have much better access to inputs, modern technology and market information. If the agricultural sector fails to improve activity and penetrate regional markets, Cambodia will become a net importer of agricultural and related products. Improving the performance of the agricultural sector is therefore urgent in the face of regional integration.

...some agricultural products might require preferential protection by import tariffs...

By joining AFTA/CEPT, Cambodia will have access to the ASEAN market, which aims to eliminate import tariffs and non-tariff barriers by the year 2003 (2006 for Vietnam). This is expected to stimulate growth of the export sectors in which revealed and potential comparative advantages lie, and hence boost economic growth.

...public investment in human resource development by education and training is essential to translate the benefits of integration into sustainable development in Cambodia. Provision of basic health and social services is also critical to improve the living standards of the Cambodian people, as well as to upgrade the capacity of human resources...

On the trade and investment policy side, strategies towards AFTA may be necessary to consider some preferential, yet time-constrained, protection of some strategic items...

...the government's role in this sector is to ensure that development will actually contribute to raising the living standards of the people by maximising the number of jobs created, exports of their products, earning of foreign currency, and tax payments for government revenue. No less important is that labour standards set in the labour law be strictly implemented to protect the living standards of workers. Industrial waste which adversely affects the environment needs to be controlled as well...

Coordination may be necessary between the public and private sectors as well. The ASEAN preparations so far appear to be limited to the government. It is not clear to what extent the private sector in Cambodia has been informed about AFTA itself or the government's policy stance towards AFTA. As the private sector will be exposed to stiff competition within the region, information of this sort will be helpful to the private sector's decision-making to prepare for AFTA. The public sector should also benefit from exchanging views with the private sector to generate a coherent policy package towards AFTA...

Reference to Mr Jeffrey Kaplan's Presentation

Looking ahead, serious questions remain regarding Cambodia's institutional capacity to handle ASEAN economic cooperation. It is not a question of interest or willingness by officials to do the work. Rather, the most pressing challenges are: 1) marshalling sufficient human resources to internalise and implement ASEAN initiatives; and 2) building inter-ministerial arrangements that can effectively generate policy options, develop and share information, and provide technical input to guide Cambodia's participation in ASEAN's various economic initiatives...

One ongoing risk is that expediency will dictate the government's response to this problem. It will take a sustained political commitment to establish the necessary institutions to handle ASEAN affairs. Although it is sometimes necessary and faster for senior officials to simply make unilateral decisions on ASEAN issues as they arise, in the long run it is imperative that institutional mechanisms and transparent decision-making procedures be created and respected. Effective integration into ASEAN requires a serious commitment to institution-building in Cambodia...

In the past few years, Cambodia has actively pursued legal reforms in connection with the liberalisation and modernisation of its economy. This trend is likely to accelerate once Cambodia joins ASEAN. On the eve of ASEAN membership, it might be useful to review the key economic-related legal reforms to date and preview forthcoming reforms.

Cambodia has already enacted an investment law (in 1994) and laws establishing a commercial register and a chamber of commerce (in 1995). A law on the organisation of conduct of the National Bank of Cambodia was passed in 1996.

Advanced drafts of numerous key laws now exist. For example, laws on business organisations, commercial arbitration, banking, copyright, bankruptcy, contracts and product liability have all been drafted. A sub-decree on investment will be approved soon to provide clearer rules and procedures for investment in Cambodia. A working group has been organised to begin drafting a new customs code and new tariff nomenclature to comply with ASEAN requirements. An insurance law has been forwarded to the National Assembly for consideration.

In order to better understand the legal commitments that will be expected or required once negotiations begin on services, the government has also organised an informal working group on services comprised of officials from the Ministry of Economy and Finance, the Ministry of Commerce, the Ministry of Tourism, the Ministry of Public Works, the Ministry of Industry, the Ministry of Posts and Telecommunications, the State Secretariat for Civil Aviation and the National Bank of Cambodia...

There are certain key challenges facing Cambodia regarding legal reform generally, and reforms associated with ASEAN in particular. The biggest challenge for law reform in ASEAN is weak human resources...

Building and strengthening Cambodia's institutional and legal infrastructure requires the commitment, energy and participation of everyone. There must be a willingness to cooperate in decision-making, to share information and ideas, and to identify Cambodia's priority areas of ASEAN cooperation to pursue...

Reference to Dr Nguyen Xuan Nguyen's Presentation

To implement AFTA/CEPT, Vietnam has set up four conditions or targets as follows:

One—Budget revenue must not be seriously affected. In order to keep a source of revenue during tariff reduction, there are two options: 1) to increase the tax base by promoting exports; and 2) to change the tax system by imposing an income tax and VAT. The development of production and trade could increase the tax base and increase revenue despite tax rate reductions. From 1991 to 1995, government revenue increased from 10,353 billion dong (14 percent of GDP) to 53,256 billion dong (24 percent of GDP); import and export duties increased from 1.4 percent to 6.6 percent of GDP and contributed about 27 percent of 1995 budget revenue.

Two—Vietnam must be able to keep its domestic production protection policy as long as possible in order to have more time to meet the challenges of AFTA. Unfortunately, the plan to hold on to the protection policy up to the year 2006 was not adequately prepared. Protection measures such as maintaining a high tariff rate, temporarily stopping and restricting the import of certain goods, and quota distribution, were taken too casually. For example, on 10 May 1997, the Ministry of Trade announced a temporary ban on the import of 12 commodities (steel, paper, cement, glass, sugar, bicycles, fans, sweets, beer, etc.). Two months later, on 23 July 1997, imports of these commodities were allowed again with no explanation. Also, reports from the various provinces and ministries continue to ask the government to keep the protection policy, without offering any detailed proposals (such as for how long, for which commodities, at what tariff rate, etc.).

Three—The promotion of industrialisation and modernisation. The target is to restructure the economy, increasing the share of manufactured goods for export, improving productivity and competitiveness. One hundred and twenty-four sites have been selected for establishing industrial parks and export-processing zones. The law on foreign investment and the law on companies have been revised in order to promote investment.

Four—The promotion of exports and FDI. In order to follow the CEPT scheme, it is necessary to recall CEPT regulations. According to the AFTA/CEPT scheme, starting from the year 2000, more than 95 percent of the total ASEAN tariff lines would be placed under the CEPT scheme. AFTA divides all products into three groups...

The challenge of a late-comer

The permission of AFTA/CEPT that allows Vietnam to complete the CEPT scheme three years later than other members countries could be assessed from two different perspectives:

First, the advantage is that Vietnam will have more time to prepare and to adjust its economic structure from a centrally planned system to a more market-based economy, changing perceptions to fit the market economy.

Second, the disadvantage is that Vietnam will fully enter the AFTA/CEPT scheme only in 2006, when all other members will have finished the CEPT scheme in 2003. This means that other ASEAN members will have completed restructuring of their economies and will be ready to share the regional market. Almost all contracts have been signed. In this case, if Vietnam's productivity is not as high as that of other members, Vietnam will not be able to integrate into the regional market in a positive and active manner, and may have to depend more on primary product production, a high trade deficit and high unemployment. This means that the Vietnamese economy will be marginalised and forced to operate on the periphery of the regional integrated market.

For Vietnam to avoid this expected challenge, it must accelerate its economic adjustment and try to complete AFTA/CEPT as soon as possible. Some economists argue that Vietnam should

complete the AFTA/CEPT scheme sooner than other ASEAN members. In that case, Vietnam will have to reduce all tariff lines by around 2002–03, as opposed to the current plan for 2006.

If this proposed option is not accepted, Vietnam will have to follow the immediate tariff reduction path instead of the ordinary tariff reduction path in order to accelerate its economic restructuring. It is expected that if Vietnam follows the immediate tariff reduction path, completes AFTA/CEPT by the year 2006, and tries to keep its protection policy as long as possible as mentioned above, it will lose almost all its recent advantages. For example, in the 21st century, cheap labour will be replaced by highly qualified labour, labour-intensive technology will be replaced by capital-intensive technology, and the price of primary products will be relatively lower in comparison with the price of high-tech products. Protected industries would not be able to compete with market-oriented industries in terms of productivity, flexibility in production, in management skills, and in international affairs.

The challenge of free cross-border trade

When the AFTA/CEPT scheme is completed, it is expected that there will be a coherent regional market, and hence each country will have less power over its economy. The change of exchange rates and interest rates in one ASEAN member country will have a direct and immediate impact on the economies of other countries. Cross-border flows of commodities and capital will be faster and larger. Competition for foreign investment flow, and for expanding exports, will be more severe...

Reference to Dr Jayant Menon's Presentation

There is concern that the losses in tariff revenue associated with joining AFTA will be considerable. In this context, the SGCL report, for instance, is concerned that "given the two countries' [Cambodia and Laos] limited revenue bases, special attention should be paid to losses in revenue arising from trade liberalisation." Trade taxes are an important source of revenue for the Lao government...

Removing tariff and other barriers to trade is likely to take away much of the incentive to engage in informal and illegal trade. Given that the risk and transaction costs associated with illegal trade are not negligible, the removal of trade barriers might then increase both the reporting and the volume of trade. The main advantage of removing the incentive to engage in illegal cross-border trade is the improvement in the reliability of recorded trade data. The increase in the share of trade that can be assessed for applicable tariffs. Thus, if reductions in tariffs (as long as they are above zero) increase the share of assessable imports substantially, then this might lead to an increase in total tariff revenue collection.

Apart from the revenue effects, there are direct costs associated with joining ASEAN. The first direct cost is the (equal) contribution made by each member towards the running cost of the ASEAN Secretariat. In 1992, for instance, the budget of the ASEAN Secretariat amounted to \$4.1 million. It is unlikely that Laos would be exempted from making such a contribution, since Vietnam did not receive any such concession. Nevertheless, Vietnam's contribution is being met by Japan. Japan or some other developed nation, such as one of the newly industrialised countries or France, could be approached to meet the costs associated with Laos' contribution.

There will be other costs associated with membership. A recent report on Cambodia suggests that it would have to spend about \$5 million during its first year as a full member (this includes the contribution towards the running of the ASEAN Secretariat, estimated at \$0.6 million per year). The costs that Laos will incur are likely to be similar to those of Cambodia. There is a \$1 million entry fee that both Cambodia and Laos will have to pay. In addition, there will be costs associated with the setting-up and running of new embassies in ASEAN countries. Laos will need to establish embassies in Singapore, Brunei and the Philippines. In the Cambodian case, each embassy is expected to cost about \$550,000 per year to run. There is also a requirement to contribute \$50,000 towards a science fund. As a full member of ASEAN, there will be some increase in incidental expenditures associated with attendance and participation in all official ASEAN and ASEAN-sponsored meetings. These are mainly costs associated with travel and accommodation for Lao officials. The SGCL report recommended that, for the first three years of full membership, such costs should be met by the ASEAN country holding the meeting.

Safety-net options

There is a significant level of apprehension among Lao officials that falls of revenue as a result of reductions of tariffs will adversely affect the revenue levels of Laos and may have negative effects on the balance of payment and levels of foreign reserves.

In this respect, it would help if donors and international institutions were prepared to provide the level of assurance which Laos officials seek, that underpinning would be provided in an appropriate form in the event that unanticipated shortfalls in revenue as a result of trade liberalisation were to affect the fiscal and monetary position of Laos.

The viewpoints above need to be carefully studied and debated further by all Cambodian government officials and members of the private sector so that our preparedness to join ASEAN is at the required level in order to maximise our chances to foster a sustainable and faster economic growth for our country, and at the same time to limit the possible damage to various sectors of our national economy.

I will now end my speech by touching another possible option that seems not so obvious to our workshop. All of you have addressed the issue of integration of Cambodia into ASEAN with the understanding that Cambodia's membership is coming soon. How soon? That's the question. The consecutive delays of our accession into ASEAN from this date to that date might start to exasperate some of my colleagues in the government. We are now approaching a critical point where the road is going in two directions. I foresee that we will arrive at this junction towards the end of this year. The ball is actually in ASEAN's court, and it depends on them: do they want us in or not? If they continue to shut the door, we will have to knock at someone else's door. Or perhaps we can develop our economy on similar lines to ASEAN's but without being tied to ASEAN's conditions and prerequisites. You know that we have developed some resilience towards economic sanctions in the past decade, though the situation of the Kingdom of Cambodia is far better than the situation of the former State of Cambodia. This option would only come as a last resort, and only if we were forced to choose it. And I hope not, for I am and I shall always be a strong advocate for Cambodia's integration into the regional and world economies, which is the only way for Cambodia to enter the 21st century with a brighter future.

Thank you

Introduction

Regional economic integration has been attracting keen interest from the Cambodian people in recent years. The crux of this issue is Cambodia's membership in the Association of South East Asian Nations (ASEAN). Progress towards Cambodia's ASEAN membership, however, has been far from smooth since the country's official application in April 1996. The fighting of 5 and 6 July 1997, precipitated by conflict between rival political parties, forced ASEAN to postpone Cambodia's membership, which had originally been scheduled for the end of July 1997. The recent political turmoil following the national election on 26 July 1998 has also been delaying the process of Cambodia's membership in ASEAN. Despite these delays and setbacks, both Cambodia and the ASEAN have on numerous occasions expressed their commitment to realising the ASEAN-10, with the inclusion of Cambodia, in the near future.

There are several pressing economic reasons for both Cambodia and ASEAN to realise the ASEAN-10.

For Cambodia, economic integration with the regional and the world economies is seen as one of the national strategies for reconstruction and development.¹ In his opening remarks at the CDRI conference held in October 1997, Keat Chhon, Senior Minister in Charge of Rehabilitation and Development and Minister of Economy and Finance, said that "despite the delay in [Cambodia's] membership, Cambodia remains determined to join ASEAN as soon as possible." In his closing speech at the conference, Cham Prasidh, Minister of Commerce, noted that "the integration of Cambodia into the regional and world economies is the single most important issue facing Cambodia today. Our economic future depends on our managing this integration successfully." More recently, Keat Chhon and Aun Porn Moniroth reiterated Cambodia's willingness and commitment to join ASEAN: "Cambodia's integration into ASEAN is a major component and a key priority for achieving its long-term development objectives."²

One of the requirements for the membership in ASEAN is to join the ASEAN Free Trade Area (AFTA), one of ASEAN's major economic initiatives of recent years. Joining AFTA is expected to bring economic advantages and benefits to Cambodia. Two major advantages have been pointed out: 1) access to ASEAN markets; and 2) becoming a platform for foreign investment. First, enterprises located in Cambodia, both local and foreign, will have access with preferential tariff rates to ASEAN markets, with a combined population of 480 million. Even considering the economic slowdown precipitated by the Asian financial crisis, the

¹ Council for the Development of Cambodia (1994), *National Programme to Rehabilitate and Develop Cambodia (NPRD)*, presented at the March 1994 ICORC-II Meeting in Tokyo, Japan.

² Keat Chhon & Aun Porn Moniroth (1998), *Economic Development of Cambodia in the ASEAN Context* (Phnom Penh: Cambodian Institute for Cooperation and Peace, July 1998).

ASEAN market has been, and potentially will be again, one of the high growth areas in the world. Access to ASEAN markets will provide enterprises in Cambodia with vast business opportunities that they could not enjoy in Cambodia's small domestic market. Second, Cambodia could become a platform for investment from foreign firms aiming to penetrate ASEAN markets. Low preferential tariffs on Cambodia's exports to ASEAN, coupled with low labour costs and a generous investment law, are expected to increase incentives to locate factories and firms in Cambodia. By joining AFTA, Cambodia will send a signal of its willingness and commitment to integrate itself into the world economy. This will give foreign investors confidence to invest in Cambodia.

For ASEAN, realising the ASEAN-10 with the inclusion of Cambodia is expected to bring not only regional political stability and security but also economic prosperity. The formation of AFTA and other ASEAN economic initiatives such as ASEAN Industrial Cooperation (AICO) and the ASEAN Investment Area (AIA) are expected to create more regional trade, improve the investment climate in ASEAN, and hence sharpen the competitive edge of its member economies in the world economy.

The formation of AFTA was a necessary response to, and a survival strategy of ASEAN in, the changing world economy. According to Joseph Tan, three fundamental changes in the economic environment in the late 1980s and early 1990s were behind the formation of AFTA.³ At the global level, the world witnessed the emergence of regional economic blocs in Europe and North America. In North America, bilateral negotiation towards a free trade area between Canada and the United States was achieved in 1989. The agreement was further extended in 1994 to include Mexico, in the North American Free Trade Area (NAFTA). In Europe, the European Community agreed to create a single market in 1992. At the regional level, the ASEAN countries, both governments and the private sector, came to recognise the increasing need for deeper economic cooperation. They saw this as a critical factor to meet the greater competitive pressures from outside the ASEAN region. At the national level, several ASEAN countries adopted similar liberalisation policies for trade and investment from the mid-1980s. The reforms emphasised development strategies based on attracting foreign direct investment (FDI). The convergence of these policies laid the foundation for the creation of an atmosphere of cooperation and compromise in the formation of AFTA.

Although Cambodia's joining ASEAN and AFTA is expected to bring economic benefits, several concerns and problems which warrant serious discussion and study remain. The benefits of regional integration will not be fully achieved without investigating thoroughly these potential problems and the challenges arising from regional economic integration.

It was in this regard that Cambodia Development Resource Institute launched a regional integration project in January 1997, and organised an international conference entitled *Cambodia: Challenges and Options of Regional Economic Integration*, in October 1997. The conference was intended to address and discuss key challenges that Cambodia would face in translating the benefits of regional integration into reconstruction and development. Experts who were engaged in policy-making and/or research in Cambodia were invited to the conference to discuss a broad range of economic issues related to Cambodia's membership in ASEAN. The areas of the discussions at the conference included: 1) institutional and legal infrastructure development; 2) macro-economic management and public finance; 3) trade and industrial development; and 4) sustainable development. The current volume collects five of the original papers presented at the conference.

Chapter One by Chan Sophal, Toshiyasu Kato and Long Vou Piseth provides background information about economic and social development in Cambodia and the ASEAN countries.

³ For an overview and in-depth studies of the economic implications of AFTA, see Tan, Joseph (1996), *AFTA in the Changing International Economy* (Singapore: Institute of Southeast Asian Studies, 1996).

With a comparative economic approach, the authors shed light on the recent state of development in Cambodia in comparison with that in ASEAN countries.

Their study reveals that Cambodia shares some common characteristics with the newest ASEAN members, Laos and Myanmar. This group of countries were in the process of transition from command to market economies, were predominantly agrarian societies with relatively abundant natural resources, and had experienced moderate economic growth and inflation in recent years. In addition, Cambodia and Laos seem to have achieved open trade and investment regimes which are comparable with other regional economies. With regard to public finance, Cambodia's weak revenue base contrasts sharply with that in the ASEAN countries. The research also points to Cambodia's high spending on defence and security as a proportion of national government expenditures—a legacy of the recent civil war.

Chan, Kato and Long also found a significant gap between Cambodia and the ASEAN countries in the area of social development, such as education, health and nutrition. Overall, the educational attainment of the Cambodians was far lower than that of people in the ASEAN countries. A wide gap between Cambodia and ASEAN was also found in health and nutritional status, and in public provision of health services. Based on these findings, the authors argue that the pace human resource development in Cambodia appears to have been much slower than that in other regional countries. They also point out that the scope for narrowing these gaps in the near future is limited, as the re-orientation of public expenditure towards social development in Cambodia have not so far been successful. They conclude from these findings that public policies towards social development should be given top priority to bridge the large gap between Cambodia and ASEAN.

In Chapter Two, Jeffrey Kaplan discusses institutional and legal implications of ASEAN membership for Cambodia, particularly for the Cambodian government. He also addresses the most important challenges as Cambodia plans to join ASEAN.

Membership in ASEAN requires the Cambodian government to build new institutions in the public sector that will carry out the country's responsibilities as a member of ASEAN. For instance, ASEAN members are required to appoint government officials who represent their country at high-level meetings. In addition, ASEAN requires member governments to establish ministerial departments responsible for handling ASEAN matters within their jurisdiction. Furthermore, member countries are required to mobilise sufficient numbers of government officials from technical to ministerial levels to participate in ASEAN meetings.

Kaplan argues that, though the Cambodian government has successfully responded to meeting some institutional requirements, serious problems regarding Cambodia's institutional capacity to handle ASEAN economic cooperation remain. He raises two pressing challenges in this regard. The first is to mobilise sufficient human resources to implement ASEAN initiatives. At present, the bulk of the work regarding preparations for membership in ASEAN falls on a relatively small number of officials who are over-worked and under-paid. As ASEAN membership implies a process that will continue for many years, developing and mobilising sufficient human resources is a critical factor for effective participation in ASEAN activities. The second challenge is to build inter-ministerial arrangements between relevant ministries. Although some progress has been made with the creation of the National AFTA Unit and the Internal Coordination Network (ICN), Kaplan points out the likelihood that policies can be made by a small number of officials who possess limited and incomplete information due to the lack of input from ministries and other agencies. He contends that improving the coordination between ministries is critical to effectively and efficiently generating policy options, developing and sharing information, and providing technical input to guide Cambodia's participation in various economic activities.

With regard to legal aspects, Kaplan notes that ASEAN membership in itself has no explicit requirement for member countries to enact legal reforms, in particular domestic laws.

However, he points out that the implementation of various ASEAN economic agreements will require Cambodia to revise or draft many laws and regulations. For instance, the implementation of AFTA will require Cambodia to pass legislation that stipulates the reduction of tariffs as set out in Common Effective Preferential Tariff (CEPT) product lists. In addition, the Framework Agreement on Services requires members to begin a process that will result in binding commitments to liberalise the service sector. Furthermore, the ASEAN Agreement on Customs requires member governments to adopt the ASEAN harmonised tariff nomenclature and to implement the customs valuation system contained in the General Agreement on Tariffs and Trade (GATT). This requires changes in Cambodia's laws and regulations that govern customs administration procedures.

Kaplan identifies weak human resources in Cambodia as the biggest challenge for the development of legal infrastructure and legal reforms associated with ASEAN initiatives. At present, there are few trained lawyers who can advise the government on the legal implications of ASEAN membership and participation in the various ASEAN economic initiatives. There are not enough government officials who are capable of negotiating and drafting agreements in English, the official language of ASEAN. Judges have to be trained to familiarise themselves with the laws created or revised to implement ASEAN agreements. More fundamentally, Kaplan argues that the court system must be significantly strengthened to properly handle the large number of new laws that will be created in the next few years as Cambodia joins ASEAN.

In Chapter Three, Kun Nhem discusses the implications of ASEAN membership for macro-economic management and public finance in Cambodia. He views Cambodia's macro-economic performance in the past few years as impressive, noting that, real GDP grew at an annual average of 6 percent during the 1991–95 period, and that inflation has been contained within single digit rates in recent years after reaching around 140 percent during 1990–92.

Kun argues, however, that Cambodia's public finances have been facing enormous challenges despite the efforts of the government in recent years. On the revenue side, Cambodia's budget revenue accounted in 1996 for only 9.1 percent of GDP, one of the lowest by international standards. Tax revenue in Cambodia accounted for only 6.5 percent in 1996 of GDP, roughly half of the average figure for other low-income countries. He points out two major causes of this weak revenue effort: pervasive tax exemptions and the poor tax/duty collection capacity of the government. First, tax exemptions granted under the Law on Investment have severely eroded the tax base. Indeed, the amount of tax exemptions granted to investors totalled \$732 million in 1996, far exceeding the \$148 million collected in customs revenues in the same year. Second, the capacity to collect non-tax revenues such as those from forestry and logging has been left weak. On expenditure management, Cambodia made significant progress by undertaking several institutional building measures and reforms in recent years. However, the re-orientation of expenditure away from defence and security towards health, education and other civil expenditures has been, and will be, an ongoing challenge.

Kun predicts that though Cambodia's joining ASEAN and AFTA will bring the opportunity to access large and dynamic regional economies in the long term, it is expected to have an adverse impact on public finance, particularly budget revenues, in the short to medium term. This is because the government has relied heavily for tax revenue on customs revenue (tariffs on imports and exports), but joining AFTA requires Cambodia to reduce import tariffs and other trade barriers. Indeed, customs revenue accounted for 64 percent of total tax revenue in 1996. To meet the challenge of the impact on public revenue, Kun argues that Cambodia's tariff reduction under the CEPT scheme should be carried out in conjunction with domestic tax reforms that strengthen and broaden the tax base. He notes that the government has already made some progress in this respect. The tariff reduction lists and reduction schedule under the CEPT scheme has been carefully selected to minimise adverse impact on customs revenue, whereas tax reforms have been undertaken to meet the challenge of expected reve-

nue shortfalls. Kun contends that maintaining political and macro-economic stability and carrying out intensive structural reforms for the transition to a market economy are the most critical factors in Cambodia's long-term competitiveness and its success in integrating with the regional and world economies.

In Chapter Four, James Robertson and Harold Pohoresky discuss Cambodia's recent trade performance in great detail, and address the key issues in designing policies for implementing AFTA.

Robertson and Pohoresky use detailed trade data from the Customs Department at the Ministry of Economy and Finance to analyse recent trade performance in Cambodia. It should be noted here that their study on trade performance was the first attempt to do this in Cambodia in two respects. First, they compiled trade data from "raw" data at the Customs Department which had not been accessible before. Second, they merged and reconciled separate files of raw data, and transformed them from Harmonised System tariff codes to Standard International Trade Classifications (SITC). The SITC, which permit more sensible aggregation of trade data than Harmonised System codes, enabled them to conduct detailed analyses of trade patterns and comparative advantage. They also pointed out a number of trade data issues in Cambodia. Among the most important is a significant discrepancy between the Customs data that they compiled and aggregate trade data reported by agencies such as the World Bank and the International Monetary Fund.

Using newly constructed trade data, Robertson and Pohoresky analyse Cambodia's recent trade performance. Cambodia's major imports consist of petroleum products (SITC-3), transport vehicles and machinery (SITC-7), and basic manufactured goods (SITC-6), which together accounted for 50 and 68 percent of total imports in 1995 and 1996 respectively. Its major exports were primarily crude materials such as rubber and wood (SITC-2), and light manufacturing products such as garments (SITC-8). These sectors added up to 81 percent and 62 percent of total exports in 1995 and 1996 respectively.

Robertson and Pohoresky note that Cambodia's re-exports, which ought to be distinguished from the normal or "domestic" exports reported above, deserve special attention. This is because re-exports play an unusually important role in Cambodia's trade, particularly in the generation of substantial government revenue and in issues related to regional economic integration. According to Robertson and Pohoresky's data, virtually all re-exports were destined for Vietnam, and consisted of beverages and tobacco (SITC-1) and machinery and transport equipment (SITC-8), mainly motorcycles. The amount of re-exports accounted for \$230 million, far exceeding the total amount of normal or "domestic" exports, which stood at \$163 million in 1996. Robertson and Pohoresky argue that, though substantial in terms of its amount at the moment, the relative importance of re-exports will almost certainly decline rapidly in the future. This is because Vietnam will eventually reduce import tariffs in its market as part of the AFTA programme, which in turn will reduce the incentive to import these products through Cambodia in the form of re-exports.

Robertson and Pohoresky also analyse the destination of trade by country and region. Customs Department data again were used to compile the trade data. According to the data, Thailand and Singapore were by far the largest trading partners of Cambodia, for both imports and exports alike. Cambodia's imports from Thailand and Singapore accounted for around 60 percent of total imports in 1995 and 1996. Total imports from ASEAN were worth almost \$800 million, or 75 percent of total imports in those years. As regards exports, Thailand and Singapore were again the largest destinations, with 75 and 60 percent of total exports in 1995 and 1996 respectively. Robertson and Pohoresky caution, however, that a large proportion of Cambodia's trade with Singapore and Thailand is likely to have been transhipped from or to other countries. Although transshipment warrants further study, exports of garment highlights this point. Cambodia's exports to the European Union (EU), mainly garments, increased sharply from \$25 million in 1995 to \$92 million in 1996. In contrast, exports to ASEAN

declined from \$300 million in 1995 to \$154 million in 1996. Robertson and Pohoresky argue that this reflects a shift in the means of transporting garment exports to EU markets, away from transshipment via Thailand towards direct exports to EU countries.

According to Robertson and Pohoresky, joining ASEAN and AFTA could transform Cambodia into an important platform for investment—for products aimed at the ASEAN market and for exports to the rest of the world in association with other ASEAN producers. They see this as “the most significant economic benefit to Cambodia from ASEAN membership.” Although noting the concern about an adverse impact on customs revenues, they contend that there is a way in which a large share of revenues can be effectively protected in the process of reducing tariff under the CEPT agreements. They point to the fact that a large share of total tariff revenue is derived from a small number of goods—petroleum, cigarettes, beer, automobiles and motorcycles. They suggest that shifting the burden from tariffs to excise taxes on these products will maintain a similar level of national revenues. They also point out that the loss of revenue will be partly offset by trade creation stimulated by the formation of AFTA. As regards the selection of tariff lines under CEPT, they propose a “progressive” approach as opposed to a “prudent” approach that some analysts advocate. Their prescription is putting virtually all goods on the inclusion list (reducing tariffs to between 0 and 5 percent within a few years), and reducing maximum tariff rates to no more than 20 percent immediately. They argue that this will not only send a clear signal to investors that Cambodia is a viable base for exports to ASEAN countries, but will also increase the chances for Cambodia to compete with new ASEAN members such as Laos, Vietnam and Myanmar in this regard.

In Chapter Five, Toshiyasu Kato discusses the challenges regional integration will pose to achieving sustainable development in Cambodia. In his view, regional economic integration is not a goal but a means to raise the living standards of the Cambodian people, which is the ultimate goal of sustainable development. Kato tries first to identify the channels and mechanisms through which regional economic integration would affect sustainable development. He then moves to some important challenges for policy-makers in Cambodia to translate the benefits of regional integration into sustainable development.

Kato identifies foreign trade and investment as the key variables that will be directly affected by joining AFTA. His analysis of trade and investment patterns reveals that ASEAN countries were by far the largest trade and investment partners for Cambodia. This indicates that joining AFTA will have significant implications for Cambodia. His analysis also finds some indications that Cambodia’s potential comparative advantage appears to exist in agricultural and agro-processing sectors, areas which have yet to be revealed or developed.

Kato notes that, since the goal of sustainable development is centred around raising people’s living standards, sustainable development necessarily involves multi-dimensional objectives. These typically include: 1) income growth with equity, particularly of the poor; 2) improved health and nutrition; 3) better education; and 4) regeneration of the environment. Any public policies regarding regional integration therefore must be addressed and implemented in a way that is consistent with those objectives if sustainable development is to be achieved. Kato identifies the following key challenges as being directly associated with the objectives of sustainable development:

The first challenge is to achieve high economic growth with equity. Kato argues that Cambodia’s development will not become sustainable unless the benefits of regional integration and economic growth are shared by all, particularly by the poor. A key policy to maintain equity is public investment in universal education, health and nutrition. As is reported in Chapter One, public investment in education and health in Cambodia has been much lower than that in ASEAN countries in recent years. A challenge to the government is, therefore, how to mobilise and use limited public resources effectively to fill the existing human resources gap between Cambodia and the ASEAN countries.

The second challenge is to promote agricultural and rural development. Agricultural products are already included in the CEPT scheme under AFTA, and will thus be exposed to competition with the ASEAN economies in the long term. Kato's study finds some indications that the productivity of agricultural products in Cambodia is in general far behind that of neighbouring countries in the region. Cambodian farmers have been facing several serious constraints—such as access to various inputs, finance, technology and information. Cambodia has not yet revealed its comparative advantage in agricultural products, where the country's potential comparative advantage appears to exist. A major challenge to the government is how to articulate AFTA/CEPT strategies to facilitate agricultural and rural development.

The third challenge is industrial and service sector development. Kato argues that these sectors have been leading sectors for economic growth since the beginning of liberalisation and the transition to a market economy. The nature of these challenges to the government is therefore different from that in the other sectors discussed above. The author argues that the government should ensure that the development of these sectors actually contributes to raising the standards of living of the Cambodian people. Setting quality standards for goods and services is a critical role for the government to make market mechanisms work better.

Regional integration will pose challenges to the regeneration of environment. This is because the growth of industrial output stimulated by regional integration will inevitably accelerate pollution of air, soil and water, and increase industrial waste, which will adversely affect the living standards of the Cambodian people. Kato argues that Cambodia should take advantage of its late-comer's position. Cambodia can learn from the experiences of environmental degradation that ASEAN countries have already encountered, and avoid repeating the same mistakes in the future.

Kato contends that the key to meeting the challenges discussed above is to establish policy coherence and coordination. The multi-dimensional objectives of sustainable development require that the government ensures regional integration policies are not only coherent in themselves, but that they are also consistent with other public policies serving different objectives, domestic and cross-border policies alike. Policy coherence will not emerge without coordination between ministries, and also coordination between the private and public sectors. Kato concludes that regional integration will contribute most effectively and efficiently to Cambodia's sustainable development if these conditions are met.

Chapter One

Cambodia in the Regional Economy A Cross-Country Study

Chan Sophal, Toshiyasu Kato & Long Vou Piseth

1. Introduction

Cambodia's membership in ASEAN was temporarily postponed in July 1997, and yet it remains an important policy issue in Cambodia. Some concerned institutions and researchers in Cambodia have engaged in debates on the political, economic and social implications of ASEAN membership for Cambodia. The debates so far have generated both pessimistic and optimistic views, and both sides have raised important points. This is especially true with respect to debate over economic implications of Cambodia's participation in the ASEAN Free Trade Area (AFTA).

However, the debates on Cambodia's ASEAN membership so far have been frequently based on a rather vague or impressionistic understanding of the regional economies. There has not yet been an effort to compare systematically the Cambodian economy with those of the ASEAN countries. This paper tries to contribute to the ASEAN debate from a comparative economic perspective. Specifically, it tries to understand the current state of development in Cambodia by identifying the differences and similarities between Cambodia and the ASEAN countries. For this purpose, various indicators were collected and constructed from national and international data sources, and are presented here in a comparative manner. The paper is also intended to provide concerned institutions and researchers with common background information on Cambodia and the ASEAN economies.

The present paper consists of three parts: economic development, social development, and the environment. Section two discusses land and population, basic factor endowments of the regional countries. Section three looks at economic development; section four at social development; and section five the environment. The final section concludes the paper with a summary of findings and policy implications.

2. Land and Population

Land and population, in economic terms, comprise the fundamental factor endowments for the economic activities of a country. International trade theory posits that the relative abundance of factor endowments determines the trade pattern of countries. Cambodia is one of the least populated and relatively land abundant countries within the region. In 1995, Cam-

bodia had a population density of 57 people per square kilometre (Table 1.1). It should be noted, however, that Cambodia's population growth in 1995 was 2.7 percent, one of the highest in the region. In the long term, this trend is likely to reduce the relative land abundance of Cambodia. Another factor which poses a serious constraint over land use in Cambodia is the areas covered by land mines.

Table 1.1. Population Statistics, 1995

	Total population (in 000s)	Female population (% of total)	Population density (pop per sq km)	Population growth (annual %)
Cambodia	10,024	51.8	57	2.7
Laos	4,882	50.7	21	2.8
Myanmar	45,106	50.2	69	1.7
Vietnam	73,475	50.7	226	2.0
Indonesia	193,277	50.1	107	1.5
Philippines	68,595	49.6	230	2.3
Malaysia	20,140	49.6	61	2.4
Thailand	58,242	49.9	114	0.9
Singapore	2,986	49.4	4896	1.9
Brunei	285	47.9	54	1.5

Source: World Bank, *World Development Indicators 1997*

The percentage of females in the total population is 52 percent, the highest among the 10 countries in the region. This is, no doubt, a reflection of two decades of civil war in Cambodia. The high proportion of women in the population highlights the importance of gender concerns in the economic and social development of Cambodia.

3. Economic Development

3.1. Income, Output Growth and Inflation

Of the 10 regional countries, Cambodia belongs to the lowest income group, known as the Southeast Asian Transitional Economies (SEATEs). The SEATEs include four countries, namely Laos, Myanmar, Vietnam and Cambodia (Table 1.2). In 1995, the SEATEs had a per capita gross national product (GNP) of between \$200 and \$350. In the same year, the so-called ASEAN-6, namely Brunei, Singapore, Thailand, Malaysia, Indonesia and the Philippines, had a per capita GNP of between \$1,000 and \$27,000. Struggling back from the devastating civil war, Cambodia's per capita GNP reached \$270 by 1995. This was still far behind the level of the six largest ASEAN economies. In fact, the diversity of income levels or stages of development within the region may be one of the most important comparisons of Cambodia and the ASEAN economies.

The growth performance of the Cambodian economy from 1988 to 1996 has been quite satisfactory. Cambodia's average annual real gross domestic product (GDP) growth rates in the periods of 1988–90 and 1991–95 were 5.3 percent and 6.6 percent respectively (Table 1.2). These growth rates exceeded those of the Philippines, Brunei and Myanmar in the same

Table 1.2. Output in 1995 and Growth and Inflation in 1990-95

	Nominal GNP	Real GDP	Real GDP growth		Inflation GDP deflator
	per capita	(constant 1987)	annual average (%)		annual average (%)
	US\$	millions of US\$	1988-90	1991-95	1991-95
Cambodia	270	1,328	5.3	6.6	54.2
Laos	350	1,772	6.2	6.3	11.1
Myanmar	-	-	-1.9	5.2	17.2
Vietnam	240	59,940	5.9	8.2	29.1
Indonesia	980	139,065	8.1	7.8	7.8
Philippines	1,050	43,193	5.2	2.3	9.6
Thailand	2,740	107,365	12.4	8.4	4.9
Malaysia	3,890	62,597	9.2	8.7	4.0
Singapore	26,730	40,173	9.7	8.5	3.6
Brunei	25,160	3,109	1.5	1.6	0.1

Source: World Bank, *World Development Indicators 1997* (data from Myanmar is unavailable)

periods. In fact, all four SEATEs had accelerated economic growth in the period 1991–95 relative to the period 1988–90. By contrast, the annual growth of the ASEAN-6 slowed down in the first half of the 1990s. Nevertheless, most of these economies still attained higher growth rates than the SEATEs in the 1990s.

Cambodia experienced 54.2 percent annual average inflation from 1991 to 1995 (Table 1.2). This is the highest rate among the 10 regional economies. Of interest to observe, all four SEATEs recorded two-digit annual average inflation in the period 1991–95, compared to one-digit annual inflation of the ASEAN-6. High inflation among the SEATEs may be due to their transition from a command to a market economy. It should be noted that after encountering record high inflation rates in 1990–93, Cambodia's annual inflation has been kept to single digits and has been more or less stable since 1994.¹

3.2. Agricultural, Industrial and Service Sectors

The agricultural sector in Cambodia produced approximately 50 percent of GDP in 1995 (Table 1.3). As the table illustrates, the industrial structure of Cambodia is similar to that of Laos and Myanmar. By contrast, the share of the agricultural sector in GDP was between 10 and 30 percent in Vietnam, Indonesia, the Philippines, Malaysia and Thailand. The two city states in ASEAN—Singapore and Brunei—were largely involved in the industrial and service sectors, which produced more than 98 percent of their GDP in 1995. From an economic point of view, a large percentage of value added in the GDP from the industrial sector, such as in the cases of Singapore and Brunei, reflects a more developed economy. The question remains as to whether Cambodia has a comparative advantage in agriculture and therefore would do well to specialise in this sector, or whether it would be more advantageous for Cambodia to emphasise the development of its industrial sector.

Table 1.3. Agriculture, Industry and Services (% of GDP)

	Agriculture		Industry		Services	
	1990	1995	1990	1995	1990	1995
Cambodia	55.6	51.3	11.2	14.4	33.2	34.3
Laos	-	51.6 ^a	-	18.2 ^a	-	30.2 ^a
Myanmar	57.3	62.6 ^b	10.5	9.3 ^b	32.2	28.1 ^b
Vietnam	37.5	27.5	22.7	30.1	39.9	42.4
Indonesia	19.4	17.2	39.1	41.5	41.5	41.3
Philippines	21.9	21.7	34.5	32.1	43.6	46.2
Thailand	12.7	10.9	37.0	39.8	50.2	49.2
Malaysia	18.7	13.0	40.3	43.2	40.9	43.8
Singapore	0.3	0.2	37.0	35.5	62.7	64.3
Brunei	2.4	3.2 ^a	54.8	42.9 ^a	42.9	54.0 ^a

Source: World Bank, *World Development Indicators 1997* (a = 1993; b = 1994)

3.3. Foreign Trade and Investment

The volume of international trade in Cambodia has increased dramatically in the 1990s as a result of various trade liberalisation measures undertaken early in the decade. In 1995, the exports and imports of goods and services in Cambodia were 35 and 50 percent of GDP, respectively (Table 1.4 overleaf). These figures are roughly as high as those of Vietnam, the Philippines and Thailand. Although it embarked on a policy of trade liberalisation only recently, Cambodia appears to have already attained fairly open trade within the region. In Cambodia, the share of current account deficits in GDP was 7 percent in 1995. This was a better current account deficit position than that of Laos (13 percent) and Vietnam (10 percent). A large amount of unilateral current transfer in the form of grants and non-repayable external assistance, which accounted for 10 percent of GDP, helped to offset the large trade deficit in Cambodia.

¹ See *Cambodia Development Review*, Volume 1, Number 1 (April 1997) for time-series data of inflation in Cambodia.

	Goods and services		Net income		Total net		Current a/c	
	Exports ^a	Imports ^a			current transfer		balance	
Cambodia	969 (35)	1,375 (50)	-57	(-2.1)	277	(10.0)	-186	(-7)
Laos	445 (25)	666 (38)	0	(0.0)	-3	(-0.2)	-224	(-13)
Myanmar	1,120	1,669	-101		312		-339	
Vietnam	7,272 (36)	9,459 (46)	-310	(-1.5)	477	(2.3)	-2,021	(-10)
Indonesia	51,160 (26)	53,244 (27)	-5,778	(-2.9)	839	(0.4)	-7,023	(-4)
Philippines	26,795 (36)	33,317 (45)	3,662	(4.9)	880	(1.2)	-1,980	(-3)
Malaysia	81,692 (96)	86,248 (101)	-3,673	(-4.3)	163	(0.2)	-4,147	(-5)
Thailand	70,292 (42)	82,219 (49)	-2,114	(-1.3)	487	(0.3)	-13,554	(-8)
Singapore	148,394 (177)	134,028 (160)	1,615	(1.9)	-888	(-1.1)	15,093	(18)

Source: World Bank, *World Development Indicators 1997* (a percentage share of GNP in parentheses)

The liberalisation of the Cambodian economy from the early 1990s attracted a significant amount of foreign direct investment (FDI). Inward FDI stock (i.e. the accumulation of annual FDI inflow) in Cambodia was \$236 million, or 8.5 percent of GDP in 1995 (Table 1.5). The percentage share of FDI stock in GDP in Cambodia was higher than that of Vietnam (2.0 percent) and Brunei (1.2 percent), but below that of the other ASEAN countries.

3.4. Public Finance

One of major challenges to transition economies is to reform the structure of public revenues. This is because, among other things, developing capacity for a modern tax system requires administrative and legal reforms which take a long time. In 1996, Cambodia's current revenue accounted for 9.1 percent of GDP, close to the lowest share

in the ASEAN countries where data are available (Table 1.6). The heavy reliance of tax revenue on trade is an additional characteristic of the public revenue structure in Cambodia.

Cambodia's total expenditure (which is equal to the sum of current and capital expenditure), however, accounted for 16.4 percent of GDP in 1996 (Table 1.6). This level was as high as that in some ASEAN countries—16.7 percent in Indonesia, 16.4 percent in Thailand, and 17.7 percent in Singapore. The high level of public expenditure in Cambodia reflects the

	FDI inward stock (millions of dollars)	FDI inward stock share in GDP (%)
Cambodia	236	8.5
Laos	225	12.8
Myanmar	38	-
Vietnam	397	2.0
Indonesia	50,755	25.6
Philippines	6,852	9.2
Thailand	16,775	10.0
Malaysia	38,453	45.1
Singapore	55,491	66.3
Brunei	62	1.2

Source: United Nations, *World Investment Report 1996*

		Current revenue	Current expend.	Total expend.	Defence expend.	Current bud. def.	Overall bud. def.	Foreign financing	Domestic financing
Cambodia ^a	1996	9.1	9.9	16.4	4.9	-0.8	-7.3	7.0	0.2
Laos		-	-	-	-	-	-	-	-
Myanmar	1994	7.2	6.4	11.0	4.1	0.8	-3.8	0.0	3.6
Vietnam		-	-	-	-	-	-	-	-
Indonesia	1993	17.1	8.5	16.7	1.0	8.6	0.4	-0.1	-0.5
Philippines	1993	17.4	15.4	18.5	2.0	2.0	-1.0	0.9	0.6
Thailand	1994	18.5	11.1	16.4	2.4	7.4	2.1	0.2	-2.0
Malaysia	1995	25.4	18.1	23.0	2.9	7.3	2.4	-	-
Singapore	1993	27.1	13.4	17.7	4.4	13.7	9.5	0.0	-15.8

^a 1995 data from the World Bank, *Cambodia: Progress in Recovery and Reform*

Source: World Bank Development Data

large amount of public investment supported by foreign assistance to the Cambodian government after the Paris Peace Agreements in 1991.

Cambodia's post-war background is reflected in the structure of public expenditure. In 1996, the Cambodian government spent 4.9 percent of GDP on defence expenditure (Table 1.6). Although the defence share declined gradually after the peace agreements in 1991, the level was still the highest in the region in 1996. The share of defence spending in Cambodia looks even more dramatic if defence expenditure is presented relative to current expenditure. Defence expenditure in Cambodia accounted for around 50 percent of current expenditure in 1996, whereas other ASEAN countries, except Myanmar, spent no more than 25 percent of current expenditure on defence.

Cambodia's overall budget deficit increased sharply in the 1990s, and reached 7.3 percent of GDP in 1996 (Table 1.6). The size of the overall budget deficit relative to GDP was the largest within the regional economies. However, Cambodia's budget deficits were

	Total	Total	Total debt service		
	external	external	% exports	% of GNP	% imports
	debt	debt	of goods/		of goods/
	millions \$	% of GNP	services		services
Cambodia	2,031	73.5	145.2	0.2	0.6
Laos	2,165	124.9	154.5	1.5	5.8
Myanmar	5,771	-	432.5	-	14.5
Vietnam	26,495	132.2	-	1.9	5.2
Indonesia	107,831	56.9	194.2	8.7	30.9
Philippines	39,445	51.5	113.5	7.0	16.0
Malaysia	34,351	42.5	33.6	8.1	7.8
Thailand	56,789	34.8	77.6	4.6	10.2
Singapore	0	0.0	0.0	0.0	0.0
Brunei	0	0.0	0.0	0.0	0.0

Source: World Bank, *World Development Indicators 1997*

largely financed from abroad, as foreign financing rapidly increased after the 1993 national election. Foreign financing in Cambodia was 7.0 percent of GDP and 42.6 percent of total expenditure, in 1996 (Table 1.6). The large inflow of grants and other non-repayable external assistance from abroad made up a major part of foreign finance in Cambodia.

In 1995, Cambodia's total external debt was 73.5 percent of GNP

(Table 1.7). This figure is much lower than that of Laos and Vietnam. In addition, total debt service as a percentage of GNP was only 0.2 percent in Cambodia, much lower than that of the other SEATEs. Furthermore, total debt service as a percentage of exports of goods and services was 145 percent, compared to that of Laos (155 percent) and Myanmar (433 percent). These figures suggest that, though the level is still high, external debt in Cambodia appears to be a less serious problem than that in the other SEATEs at the present time.

Nevertheless, Cambodia has been relying heavily on foreign aid since the Paris Peace Accords. In 1995, overall official development aid per capita was \$56 in Cambodia (Table 1.8). This amount was the second highest, after Laos (\$64 per capita), among the 10 regional

	Official	Aid	Aid dependency ratios		
	devel.	per	Aid as	Aid as %	Aid as %
	assistance	capita	% of GNP	of gross	of imports
	and aid		domestic	of goods/	
	millions \$	\$	investment	services	
Cambodia	7	56	20.5	105.0 ^b	39.2
Laos	311	64	18.0	-	46.3
Myanmar	141	3	-	-	9.1 ^a
Vietnam	826	11	4.1	22.6 ^a	8.4
Indonesia	1390	7	0.7	1.9	2.3
Philippines	884	13	1.2	5.3	2.5
Thailand	863	15	0.5	1.2	1.0
Malaysia	114	6	0.1	0.3	0.1
Singapore	16	6	0.0	0.1	0.0
Brunei	4	15	0.1	-	-

Source: World Bank, *World Development Indicators 1997*

a 1994; b gross domestic investment data from the National Institute of Statistics

economies. Aid as a percentage of GNP in Cambodia was 20.5 percent, the highest among the regional countries.

3.5. Financial Development

The financial sector plays a critical role in mobilising financial resources for development activities in both the private and public sectors. It channels available financial resources from savers to firms and the government, which need funds to invest in physical and human capital development in Cambodia.

The ratio of money and quasi-money (M2) as a percentage of GDP is often called the *financial deepening indicator*, which tends to increase as the banking sector in an economy develops.² This is because quasi-money, such as time- and saving-deposits, tends to expand rapidly in the course of banking sector development. A contrast of banking sector development between the SEATEs and the ASEAN-5 can be observed in Table 1.9. In 1995, Cambodia's financial deepening indicator was 7.7 percent, the lowest level in the regional economies from which data are available. The same ratios in the ASEAN-5 economies were relatively high, particularly in Singapore and Malaysia, where the ratios were 83 percent and 85 percent of GDP in 1995 respectively.

Cambodia's nominal deposit and lending rates, 8.7 and 18.7 percent respectively in 1995, were relatively high, and their differential of 10 percent was close to the 11.7 percent of Laos (Table 1.10). The differential between the deposit and lending rate reflects, partly, the degree of confidence in the banking system. The differentials were much smaller in more developed economies such as Singapore, Malaysia and Thailand, whereas large gaps between the two rates existed in less developed economies such as Cambodia and Laos.

The domestic currencies of the ASEAN-9 countries from 1989 to 1995 were relatively stable in terms of the US dollar, except for Indonesia (Table 1.11). The Indonesian rupiah depreciated about 28 percent, from 1,797 rupiah to the dollar in 1989 to 2,308 rupiah in 1995.

The Cambodian riel experienced major depreciation

	1990	1995
Cambodia	-	7.7
Laos	6.9	12.7
Myanmar	24.1	-
Vietnam	-	-
Indonesia	33.9	-
Philippines	30.9	45.4
Thailand	62.4	73.8
Malaysia	63.1	85.0
Singapore	85.7	82.6
Brunei	-	-

Source: World Bank, *World Development Indicators 1997*

	Deposit	Lending	Differential
Cambodia	8.7	18.7	10.0
Laos	14.0	25.7	11.7
Myanmar	9.0	16.5	7.5
Indonesia	15.3	17.9	2.6
Philippines	8.4	14.7	6.3
Malaysia	5.9	7.6	1.7
Thailand	11.6	15.0	3.4
Singapore	3.5	6.4	2.9

Source: IMF, *International Financial Statistics* (November 1996)

	1989	1990	1991	1992	1993	1994	1995
Cambodia	216	600	520	2,000	2,305	2,575	2,526
Laos	714	696	712	717	718	719	923
Myanmar	6.49	6.08	6.01	6.24	6.24	5.90	5.78
Vietnam	-	-	-	-	-	-	-
Indonesia	1,797	1,901	1,992	2,062	2,110	2,200	2,308
Philippines	22.4	28.0	26.6	25.5	27.1	26.4	25.7
Thailand	25.7	25.3	25.3	25.5	25.5	25.5	25.1
Malaysia	100	100	98	106	105	103	107
Singapore	1.89	1.74	1.63	1.64	1.60	1.46	1.41

Source: IMF, *International Financial Statistics 1996*

² The financial deepening indicator is an inverse of income velocity over money.

in the process of the transition to a market economy in the first half of 1990s. It depreciated by about 1,070 percent, from 216 riels per dollar in 1989 to 2,526 riels per dollar in 1995. The high depreciation of the Cambodian riel could partly be due to the large inflow of dollars and political uncertainty during the UNTAC period. The depreciation of the domestic currency raises the prices the imported goods, thus adversely affecting the cost of living of ordinary people in Cambodia.

4. Social Development

4.1. Education

The importance of education for development has been well recognised among development researchers and practitioners. Education directly improves people's standards of living in developing countries by upgrading people's capacity to obtain better jobs and earning opportunities. In addition, development of human capacity also contributes to boosting economic growth, as a more skilled labour force becomes available for both the private and public sectors. Furthermore, universal education contributes to eradicating poverty and mitigating inequality, an overriding objective of development in Cambodia. The development experience of the East Asian countries provides ample evidence to support this argument. It is important, therefore, to identify where Cambodia's education stands compared to other countries in ASEAN.

The adult literacy rate is one of commonly used indicators to assess the capacity of human resources in a country. According to the *Human Development Report* (1996), Cambodia's adult literacy rate was 36 percent, the lowest among the 10 regional countries. A more recent study by the Ministry of Planning, however, found that the adult literacy rate in 1996 was 68.7 percent (Table 1.12).³ Although this rate was significantly higher than that of the previous UNDP estimate, the adult literacy rate in Cambodia appears to be much lower than that of other countries in the region, which, except for Laos, recorded rates of more than 80 percent.

	Population	Adult literacy			Gross primary		Gross secondary		Female	Life expectancy	
	sex ratio	rate ^a			enrol. ratio		and tertiary		labour	at birth	
	(women per	(percentage)			(percentage)		enrol. ratio ^a		force	(years)	
	100 men)						(percentage)		(%)		
	1995	1993			1993		1993		1995	1995	
		Male	Female	Total	Male	Female	Male	Female		Male	Female
Cambodia	108	81.8 ^b	58.0 ^b	68.7 ^c	-	86 ^d	-	-	53	52	54
Laos	103	67.7	42.1	54.6	123	92	58.9	42.1	47	51	54
Myanmar	101	88.3	76.6	82.4	-	-	49.4	47.8	43	58	61
Vietnam	103	95.8	89.5	92.5	-	-	53.2	49.2	49	65	70
Indonesia	100	89.1	76.9	82.9	116	112	63.7	58.2	40	62	66
Philippines	99	94.6	93.9	94.2	-	-	76.2	78.4	37	64	68
Thailand	100	95.9	91.4	93.6	98	97	54.0	54.9	46	67	72
Malaysia	98	88.2	76.3	82.2	93	93	59.7	61.5	37	69	74
Singapore	98	85.0	95.6	90.3	-	-	69.3	66.5	38	74	79
Brunei	92	91.7	81.6	87.0	111	104	69.4	69.9	34	73	78

a UNDP, *Human Development Report 1996*; b 1996 data from Ministry of Planning, *Demographic Survey of Cambodia 1996*; c according to UNDP, *Human Development Report 1996*; Cambodia's literacy rate was 35 percent; d 1996 data from Ministry of Education, *Education Indicators 1996/97*. Source: World Bank, *World Development Indicators 1997*

³ Royal Government of Cambodia, *Demographic Survey of Cambodia 1996* (Phnom Penh: Ministry of Planning & United Nations Population Fund, October 1996).

Access to education

School age children in developing countries often lack access to education for various reasons such as poverty, lack of facilities and teaching staff, poor road conditions which make it impossible for children to travel to school, and so on. In 1996, Cambodia's gross enrolment ratio at primary level was 95 percent (Table 1.13). This was still one of the lowest rates among the regional countries. Cambodia's 1996 gross enrolment ratio at secondary level was 31 percent, higher than the 25 percent rate of Laos, but lower than the ratios of the rest in the region, especially compared with the Philippines, Singapore and Malaysia. In 1995, Cambodia's combined enrolment at primary, secondary and tertiary levels was 30 percent, the lowest of the 10 regional countries. These data again indicate that the size and capacity of the Cambodia's education system was relatively weak.

Table 1.13. Access to Education, 1993

	Gross enrolment ratio			
	Pre-primary	Primary	Secondary	Tertiary
	% of relevant age group	% of relevant age group	% of relevant age group	% of relevant age group
Cambodia	-	95 ^a	31 ^a	-
Laos	7	107 ^b	25 ^c	2
Myanmar	-	-	-	-
Vietnam	30	111	35	2
Indonesia	35	114 ^c	43	10
Philippines	12	111	79	26
Thailand	50	98	37	19
Malaysia	35	93	59	-
Singapore	-	107	78	-

^a 1996-97 data from Ministry of Education; ^b percentage of repeaters in total more than 25%;

^c percentage of repeaters in total from 5 to 9 percent.

Source: World Bank, *World Development Indicators 1997*

Female education

Female education may need special attention in Cambodia. The adult literacy rate of women in Cambodia was 58 percent in 1996, which was higher only than Laos among the regional countries. Gross primary enrolment ratio of girls in Cambodia was 86 percent, the lowest among countries where data were available. This indicates that the gap between male and female education is apparently higher in Cambodia than in the ASEAN countries.

Education policy

The regional countries have similar policies towards primary education in terms of school age and the duration of primary education (Table 1.14). Children in Cambodia start primary

Table 1.14. Education Policy and Infrastructure

	Primary school starting age (years)	Duration of primary education (years)	Public spending on education				Primary school pupil/teacher ratio (pupils per teacher) 1993
			Primary % of GDP 1992	Secondary % of GDP 1992	Tertiary % of GDP 1992	Total % of GDP 1992	
			Cambodia	6	6	-	
Laos	6	5	0.7	0.8	0.1	1.6	30
Myanmar	5	5	1.3 ^a	-	0.2 ^a	-	-
Vietnam	6	5	-	-	-	-	35
Indonesia	7	6	0.0 ^b	0.4 ^b	0.1 ^b	0.5 ^b	23
Philippines	7	6	1.4 ^b	0.2 ^b	0.1 ^b	1.7 ^b	33
Thailand	6	6	1.6	0.6	0.5	2.7	19
Malaysia	6	6	1.7 ^c	1.7 ^c	0.7 ^c	4.1 ^c	20
Singapore	6	6	0.9 ^a	1.2 ^a	1.0 ^a	3.1 ^a	26
Brunei	6	6	0.7	1.2	0.1	2.0	16

^a 1987 data; ^b 1988 data; ^c Ministry of Education expenditure only; ^d 1996 data from World Bank, *Cambodia: Progress in Recovery and Reform*; ^e Ministry of Education, *Education Indicators 1996/97*

Source: World Bank, *World Development Indicators 1997*

schooling at the age of 6 and finish in six years. Myanmar is the only ASEAN member country whose children start primary school at the age of 5, whereas in Indonesia and the Philippines, children start primary schooling from 7 years old.

Although the Cambodian government has been emphasising the importance of public education, public spending on education in Cambodia far fell short of that in ASEAN countries. In 1996, Cambodia's total public spending on education accounted for only 1 percent of GDP, compared to an average 2.2 percent in the other countries (Table 1.14). By contrast, Malaysia spent 4.1 percent of GDP in 1992, the highest in the region. Singapore's and Thailand's spending on education were 3.1 percent and 2.7 percent respectively.

An indication of the quality of education is the pupil-teacher ratio, with low ratios indicating high quality. In 1996, the number of pupils per teacher at the primary level in Cambodia was 44, the highest among the regional countries (Table 1.14). The same indicator in the ASEAN countries ranged from 16 to 35 pupils in 1993. Having the largest number of students per teacher suggests that the capacity and quality of primary schooling in Cambodia may be the weakest in the region.

4.2. Health and Nutrition

Improving health and nutrition is in itself a major objective of social development in Cambodia, as it directly raises the living standards of the Cambodian people. It also contributes to capacity development of human resources, which will enhance potential for productivity gains and high economic growth in the future. In this sense, improving health and nutrition has a common objective with education and training. This sub-section assesses the current status of health and nutrition in Cambodia and the ASEAN countries.

Access to health services

With only 25 percent of the population having access to health care in 1993, only 13 percent access to safe water in 1994–95, and only 14 percent access to sanitation in 1990–95, Cambodia had one of the poorest standards of health in the region (Table 1.15). Only 49 percent of births in Cambodia were attended by health staff in 1990. This figure is the second lowest, above 36 percent in Indonesia, and is far below the average rate of nearly 90 percent in other regional countries.

However, Cambodia's child immunisation rate in 1995 was comparable with the other countries, though this was largely dependent on international humanitarian aid. Nearly 80 percent of children aged under 12 months had access to immunisation programmes in 1995.

Table 1.15. Access to Health Services

	Health care	Safe water	Sanitation	Child immunisation		Births
	% of pop. with access	% of pop. with access	% of pop. with access	Measles % of children under 12 mo.	Diphtheria % of children under 12 mo.	attended by health staff % of total
	1993	1994-95	1994-95	1995	1995	1990
Cambodia	25 ^a	13	14 ^b	75	79	49 ^c
Laos	67 ^b	41	30	65	51	-
Myanmar	60 ^b	39	42	66	69	97
Vietnam	97	38	21	95	93	95 ^c
Indonesia	43	63	55	89	91	36 ^c
Philippines	-	84	75	86	85	76
Thailand	59	81	87	86	93	71
Malaysia	88	90	94	81	90	92
Singapore	100	100	100	88	95	100

a data from Ministry of Health; *b* 1990-95 data from UNDP, *Human Development Report 1996*; *c* 1983-94 data from UNDP, *Human Development Report*. Source: World Bank, *World Development Indicators 1997*

Risk factors in health

Babies in Cambodia tend to be born low in weight and suffering from malnutrition more frequently than those in other regional countries. For every 100 babies born in Cambodia in 1993–94, 18 had a low birth weight (Table 1.16). This was the second highest figure among the regional countries. At the same time, 32 percent of Cambodian children aged under 5 in 1993–94 encountered malnutrition, similar to the proportion in Laos, Myanmar, Vietnam, Indonesia and the Philippines.

The adult population in Cambodia also encountered high risk factors in health, particularly in HIV infection. For every 100 adult Cambodians, 1.9

showed HIV-1 sero-prevalence in 1994. This figure is close to 2.1 in Thailand, the highest rate of infection in the region. The high risk data of Cambodia partly confirms the poor capacity of the health system in Cambodia.

Table 1.16: Risk Factors in Health

	Low birthweight babies (% of births)	Prevalence of child malnutrition (% children under 5)	Adult HIV-1 sero-prevalence (per 100 adults)
	1990	1989-95	1994
Cambodia	18 ^a	32 ^a	1.9
Laos	13	40	0.0
Myanmar	13	31	1.5
Vietnam	17	45	0.1
Indonesia	8	39	0.0
Philippines	33 ^b	30	0.1
Thailand	10	13	2.1
Malaysia	8	23	0.3
Singapore	7	14	0.1

^a 1993-94 data from Ministry of Health; ^b 1985-95 data from UNDP, *Human Development Report 1996*

Source: World Bank, *World Development Indicators 1997*

Mortality

Cambodia's mortality rates were among the highest in the region in 1995 (Table 1.17). Cambodia's life expectancy in 1995 was 52 years for men and 54 for women. These were far below the other ASEAN countries, except for Laos. In addition, Cambodia's infant mortality rate per 1,000 live births was 108, much higher than rates in other regional countries, which ranged from 4 to 90. Furthermore, Cambodia's child mortality rate was 158 per 1,000, compared with rates in other regional countries ranging from 6 to 147. There was a similar pattern in the maternal mortality ratio. Cambodia recorded a maternal mortality ratio of 900 per 100,000 live births in 1995, much higher than that in the rest of the region. Finally, Cambodia's adult mortality rate, 444 per 1,000 for men and 375 per 1,000 for women, was the second highest after Laos.

Table 1.17. Mortality, 1995

	Life expectancy at birth		Infant mortality rate (per 1,000 live births)	Child mortality rate (per 1,000)	Adult mortality rate (per 1,000)		Maternal mortality ratio (per 100,000 live births ^a)
	Male (years)	Female (years)			Male	Female	
Cambodia	52	54	108	158	370	298	900
Laos	51	54	90	147	444	375	650
Myanmar	58	61	83	119	308	252	580
Vietnam	65	70	41	49	206	136	160
Indonesia	62	66	51	75	262	205	650
Philippines	64	68	39	53	254	189	280
Thailand	67	72	35	42	199	119	200
Malaysia	69	74	12	14	194	123	80
Singapore	74	79	4	6	143	82	10

^a from UNDP, *Human Development Report 1996*

Source: World Bank, *World Development Indicators 1997*

Health policy and personnel

The above data indicates that the Cambodian people's status of health and nutrition was on average much lower than that in the ASEAN-5 countries over recent years, though some indicators in Cambodia recorded a better performance than those in other SEATEs.

Table 1.18: Health Spending and Personnel

	Health expenditure			People per physician 1993	People per nurse 1993	People per hospital bed 1993
	Total	Public	Private			
	(% of GDP) 1990-95 ^{a,b}	(% of GDP) 1990-95 ^a	(% of GDP) 1990-95 ^a			
Cambodia	7.2	0.7	6.5	9,374	1,231	453
Laos	2.6	0.8	1.4	4,446	493	405
Myanmar	0.9	0.5	0.4	12,528	1,227	1,605
Vietnam	5.2	1.1	4.1	2,279	1,149	261
Indonesia	1.5	0.7	0.8	7,028	2,732	1,423
Philippines	2.4	1.3	1	8,273	-	780
Thailand	5.3	1.4	3.9	4,416	1,067	765
Malaysia	-	1.4	-	2,441	480	437
Singapore	3.5	1.1	2.4	714	-	275

^a Data are from the most recent year available; ^b Totals may not add up due to rounding

Source: World Bank, *World Development Indicators, 1997*

Although the need for public provision of health services is extremely high in Cambodia, the capacity of existing health services fell short of that in other regional countries. Health spending by the public sector in Cambodia accounted for only 0.7 percent of GDP, one of the lowest figures in the region (Table 1.18). The shortage of public health services puts a heavy burden on individuals in Cambodia, where private health expenditures accounted for 6.5 percent of GDP in recent years. Health personnel and infrastructure available to the Cambodian people appear to be poor as well. The numbers of Cambodians per physician, nurse and hospital bed in 1993 were 9,374, 1,231 and 453, respectively, which ranked Cambodia in a group of the least staffed and equipped countries for health services.

5. Environment

Deforestation

Cambodia is richly endowed with forest compared to other countries in the region. In 1990, Cambodia's forest area was 122,000 square kilometres, larger than those of Vietnam, Philippines and Singapore, but smaller than of the other countries (Table 1.19). Deforestation was moderate from 1980 to 1990, when Cambodia's annual deforestation rate was 1,300 square kilometres and the percentage change 1 percent, both one of the lowest in the region.⁴

However, Cambodia's forest situation has undergone dramatic changes in the 1990s. Serious concern has

Table 1.19. Deforestation

	Forest area (thousands of square km) 1990	Annual deforestation	
		(thousands of square km) 1980-90	(percentage change) 1980-90
Cambodia	122	1.3	1.0
Laos	132	1.3	0.9
Myanmar	289	4.0	1.3
Vietnam	83	1.4	1.5
Indonesia	1,095	12.1	1.1
Philippines	78	3.2	3.4
Thailand	127	5.2	3.5
Malaysia	176	4.0	2.1
Singapore	0	0.0	2.3

Source: World Bank, *World Development Indicators, 1997*

⁴ Comparisons based on more recent data are more favourable, but the data from the regional countries were not available for this comparative study.

been raised in recent years over forest exploitation and management. Exports of logs and timber have accelerated in recent years, concessions for logging companies have continued to be granted, illegal logging activities have flourished. A recent government report on forest policy noted the progress of forest policy to tackle these issues, yet there appears to remain scope for further improvement.⁵

Freshwater resources

Cambodia had the largest amount of freshwater resources in cubic metres per capita among the regional countries, except for Laos, according to 1995 data (Table 1.20). By contrast, Cambodia's annual freshwater withdrawal was 0.1 percent of total resources in the same year, the lowest withdrawal rate in the region. This implies that abundant freshwater resources in Cambodia remained largely untouched compared to those in other regional countries. The largest share of Cambodia's annual freshwater consumption was for agriculture, the lowest for industrial and domestic use, reflecting under-development in the industrial and domestic sectors in Cambodia. Furthermore, the Cambodian people's access to safe water, both in rural and urban areas, was far behind other countries.

Table 1.20. Freshwater Resources

	Freshwater resources		Annual freshwater withdrawal				Access to safe water	
	cubic metres per capita	billions cubic metres ^a	% of total resources ^a	% used for agric. ^b	% used for industry ^b	% used for domestic ^b	% urban pop. 1993	% rural pop. 1993
	1995							
Cambodia	49,691	0.5	0.1	94	1	5	20	12
Laos	55,305	1.0	0.4	82	10	8	34	36
Myanmar	23,988	4.0	0.4	90	3	7	38	36
Vietnam	5,117	28.9	7.7	78	9	13	100	66
Indonesia	13,090	16.6	0.7	76	11	13	86	56
Philippines	4,709	29.5 ^d	9.1	61	21	18	-	-
Thailand	3,073 ^c	31.9	17.8 ^c	90	6	4	89	72
Malaysia	22,642	9.4 ^d	2.1	47	30	23	100	80
Singapore	201	0.2 ^d	31.7	4	51	45	100	-

a Data refers to any year from 1980 to 1995 unless otherwise noted; *b* Sectoral withdrawal percentages are estimates for 1987; *c* Total water resources include river flows from other countries; *d* Data refers to estimates made for years before 1980

Source: World Bank, *World Development Indicators 1997*

Energy production and use

Cambodia produced the least commercial energy among the regional countries in 1994 except for Singapore. It produced 22,000 tons of oil equivalent, which was hundreds of times less than any of the other countries other than Laos, which produced only 10 times as much (Table 1.21). Again, with the exception of Laos, Cambodia also used the least amount of commercial energy in 1994. The data show a big difference between the SEATEs and the ASEAN-5. In 1994, the SEATEs used much less commercial energy and saw lower average annual percentage growth of commercial energy use from 1990 to 1994 than the ASEAN-5. Conversely, the SEATEs consumed much more traditional fuel than the other countries. As a consequence, 1992 data show that carbon dioxide emissions from industrial processes were lower in the SEATEs than in the ASEAN-5.

⁵ See Royal Government of Cambodia (1997), *Recent Developments in Forest Policy: An Overview*, and World Bank/UNDP/FAO (1997), *Recent Developments in Forest Policy: Overview and Recommendations*, both of which were prepared for the Consultative Group meeting on Cambodia held in Paris from 1 to 2 July 1997.

Table 1.21. Energy Production, Use and Emissions

	Commercial energy production		Commercial energy use		kg of oil equiv. per capita 1994	Traditional fuel % of total energy use 1993	Carbon dioxide emissions from industrial processes	
	000s tons oil equiv. 1994	000s tons oil equiv. 1994	average annual percentage growth 1980-90	average annual percentage growth 1990-94			tons per capita 1992	kg per \$ of GDP 1992
	Cambodia	22	512	2.5	0.5	52	72.9	0.1
Laos	215	182	1.8	2.5	38	84.8	0.1	0.2
Myanmar	2,164	2,181	-0.1	4.5	49	71.3	0.1	..
Vietnam	11,252	7,267	4.0	7.2	101	51.1	0.3	0.5
Indonesia	153,160	69,740	7.4	7.7	366	34.3	1.0	1.7
Philippines	6,081	21,199	2.6	4.2	316	31.3	0.8	1.3
Thailand	17,362	44,395	9.5	9.7	769	35.9	2.0	1.3
Malaysia	57,011	33,410	9.4	11.0	1,699	6.5	3.8	1.5
Singapore	0	23,743	7.2	16.0	8,103	0.0	17.7	1.6

Source: World Bank, *World Development Indicators 1997*.

Urbanisation

In 1995, Cambodia along with Vietnam had 21 percent of its total population living in urban areas, compared with urban population rates in the rest of the region ranging from 22 percent in Laos to 100 percent in Singapore (Table 1.22).

This may reflect the fact that the SEATEs' urban areas were relatively smaller or less congested than those in the ASEAN-5. However, the average annual percentage growth of the urban population was 6.5 percent in Cambodia and Laos, a high rate and by far the highest in the region. This raises concerns about the problem of increased urban congestion in these countries.

Table 1.22. Urbanisation

	Urban population			Population in largest city as % of urban population 1995
	millions 1995	% of total population 1995	average annual % growth 1990-95	
Cambodia	2.1	21	6.5	63 ^a
Laos	1.1	22	6.5	53 ^a
Myanmar	12.2	27	3.3	32
Vietnam	15.3	21	3.1	23
Indonesia	66.3	34	3.9	17
Philippines	36.6	53	4.4	25
Thailand	20.9	36	2.3	50
Malaysia	10.8	54	4.0	11
Singapore	3.0	100	2.0	100

^a 1990 data

Source: World Bank, *World Development Indicators 1997*.

6. Conclusion

This cross-country presentation has focused on a comparative view of Cambodia and the nine ASEAN member countries as a contribution to the discussion of Cambodia's membership in ASEAN. In general, it appears that Cambodia shares some common characteristics with Laos and Myanmar, which both joined ASEAN in July 1997. These three countries are predominantly agrarian, are relatively land abundant, and have low income per capita. The three are also in the process of transition from command to market economies. In recent years, they have experienced moderate economic growth and high rates of inflation. At the same time, Laos and Cambodia appear to have already achieved an open international trade and investment regime comparable with other regional economies. As for public finance, Cambodia and Myanmar have weak public revenue base, which contrasts sharply with that in the ASEAN-5 countries. The high share of defence expenditure in Cambodia relative to that in

the ASEAN-5 is a legacy of Cambodia's long-running civil war. Cambodia depends heavily on foreign assistance, but more on foreign aid than on loans. A modern banking system in Cambodia and Laos is still under-developed relative to that in the ASEAN-5, particularly Singapore, Malaysia and Thailand.

This study also revealed Cambodia's urgent need to catch up with the other regional economies, particularly in the area of social development. Cambodia's adult literacy and school enrolment rates are much lower than those in other regional countries. Female education appears to be particularly weak in Cambodia, and needs special attention. Public spending on education in Cambodia was small relative to other countries. This indicates that Cambodia's educational development lags behind that in the ASEAN countries.

This in turn implies that the pace of upgrading human resource capacity in Cambodia may be slower than in other regional countries, and that the already existing gap of human resource capacity between Cambodia and the ASEAN countries therefore may widen even further in the future. Education is an investment for future generations. Returns on investment in education are not visible as immediately as that in financial or infrastructure investment. In the long term, however, public investment in education will reward future generations enormously. It will create and enhance a dynamic and flexible population and society in Cambodia, which are indispensable in the rapidly changing world.

Health indicators related to the access of services, safe water and sanitation are also much lower in Cambodia than in the other countries. Cambodian people, both children and adults, are exposed to much higher risk factors in health and higher mortality rates than people in other regional economies. Provision of public health services is highly inadequate compared with other regional countries. The low public provision of health services puts a heavy financial burden on the Cambodian people, who spend the highest private expenditures relative to GDP within the region.

Good health and education are both essential for the improvement of people's living standards. They also contribute directly to the upgrading of human resources and prepare capable and motivated personnel for productive economic contributions in both the private and public sectors. Health and education therefore are critical priorities for sustainable development in Cambodia, and for Cambodia's meaningful participation in the regional ASEAN economy.

This study revealed Cambodia to be one of the most richly endowed countries in terms of forest and freshwater resources in the region. These resources remained largely untouched until recently, due to civil war and Cambodia's isolation from the rest of the world. The current study does not provide information about the most recent situation of deforestation in Cambodia and the ASEAN countries due to the lack of comparable data. However, as some recent reports indicate, concerns have been expressed about over-exploitation of forest resources in Cambodia.⁶ The enormous economic and social costs which arise from deforestation have been documented in various studies of neighbouring countries in the region. Cambodia should take advantage of its latecomer's position, which enables it to control and prevent the environmental degradation that neighbouring countries have already encountered. The same argument also applies for other serious environmental problems such as air pollution, industrial hazardous wastes and traffic congestion.

⁶ See, for instance, Royal Government of Cambodia (1994), *Cambodia: First State of the Environment* (Phnom Penh: Ministry of Environment, 1994).

Chapter Two

Cambodia's ASEAN Membership: The Institutional and Legal Challenges

Jeffrey Kaplan¹

Cambodia's plans to join the Association of Southeast Asian Nations (ASEAN) have faced major challenges and setbacks over the past year. Although the timing of Cambodia's admission into ASEAN remains unsettled, neither ASEAN nor Cambodia has seriously questioned its eventual entry into the regional grouping. Indeed, the new ASEAN logo includes 10 rice stalks to signify the eventual membership of all 10 nations in Southeast Asia. The only question that remains—at the political level—is the timing of Cambodia's entry.

While Cambodia's membership in ASEAN is an event, Cambodia's integration with ASEAN is a process that will continue for many years. Integrating with ASEAN will require far-ranging adjustments. This paper focuses on two areas in which ASEAN membership will bring long-term change to Cambodia: institution building and legal reform. These two areas are vital to Cambodia's regional economic integration. The first, institutional reform, addresses the structure and operation of the public sector, *i.e.* how the government will carry out its responsibilities in managing the country's economic development as well as ASEAN integration. The second, legal reform, involves the basic rules that will govern Cambodia's economic development and also its participation in ASEAN.

For each topic, this paper briefly outlines key challenges posed by ASEAN membership and the basic requirements of ASEAN integration. Particular attention is given to participation in ASEAN economic arrangements, especially the ASEAN Free Trade Area (AFTA). The paper also surveys accomplishments achieved to date, while noting certain essential tasks and issues that remain. Finally, it comments on the long-term challenges confronting Cambodia as it plans its participation in ASEAN. It should be noted that many of the issues and obstacles related to joining ASEAN are equally relevant to Cambodia's future economic integration with the World Trade Organisation (WTO) or the Asia-Pacific Economic Cooperation (APEC). They also relate to Cambodia's larger ambitions for national development.

1. Institutional Reform

1.1 Fundamental Challenges

In many respects, the biggest challenge posed by ASEAN membership is institutional in nature. Effective participation in ASEAN requires a high level of intra-governmental communication and coordination. Putting aside areas of functional cooperation, ASEAN economic cooperation alone covers a broad and varied range of activities and initiatives, many of which are inter-related and highly technical in nature.

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For example, ASEAN's *Framework Agreement on Enhancing Economic Cooperation* maps out future economic cooperation in intellectual property and technology transfer, customs, tariffs, non-tariff barriers, investment, trade, industrial development, energy, finance, tourism, services, agriculture and transportation. More specific agreements for many of these areas have already been concluded, and even more specific action plans and memoranda of understanding are being drafted. Moreover, the scope of ASEAN's economic cooperation is expanding each year.

Remaining effectively engaged in this process is a continuous challenge for each ASEAN government. For Cambodia, which has thin human and financial resources, this will test the government's ability to manage and implement ASEAN's economic cooperation.

A second fundamental challenge is increasing the transparency of the process of government decision-making in Cambodia. Transparency of laws and procedures is an explicit requirement for all ASEAN members. Indeed, Cambodia will sign documents of admission into ASEAN that will include specific commitments on transparency. Such transparency requires government procedures and laws to both be disseminated and consistently followed by the government. It also means that the written legal procedures for decision-making used by government bodies must be consistent and respected.

1.2. Requirements

With these major challenges in mind, ASEAN membership carries specific institutional requirements for Cambodia. Though not required by any ASEAN agreement, participating in ASEAN in practice requires governments to establish certain administrative structures and bodies. For example, each ASEAN member country must have a National ASEAN Secretariat to coordinate ASEAN affairs. People must be appointed to serve as a country's Senior Economic Official, member of the AFTA Council, representative to the ASEAN Economic Ministers Meeting and representative to the ASEAN Senior Economic Officials Meeting.

In addition, key economic-related ministries require departments, or focal points at least, responsible for handling ASEAN matters within their ministry's jurisdiction. AFTA—ASEAN's most significant trade initiative to date—requires a governmental department or unit dedicated to supervising its implementation. Other areas of ASEAN economic cooperation, such as services, finance, industry and investment, are cross-disciplinary and have an impact on many ministries and agencies. Inter-ministerial arrangements are needed to ensure that these issues are properly addressed.

In many respects, the ASEAN way of conducting business is through an intensive schedule of meetings throughout the year covering every area of ASEAN cooperation and interest. Each year, ASEAN convenes or participates in over 300 meetings. Not surprisingly, economic-related meetings, both at the political and technical level, form a large proportion of these meetings. For example, senior economic officials typically meet four times each year to discuss both policy issues, technical cooperation and preparations for the yearly ASEAN Economic Ministers Meeting. In addition, a variety of technical meetings are held regularly, between ASEAN customs officials, for example, or a working group drafting a new ASEAN tariff nomenclature. In general, ASEAN creates technical committees related to these and other areas of economic cooperation as needs arise.

Since the process of ASEAN cooperation is driven by meetings at which policy decisions are debated, formulated and resolved, participation in ASEAN in large part means never-ending preparations for ASEAN meetings by member countries. This meeting schedule places a heavy burden on officials in each ASEAN member country. First, each ASEAN member state must mobilise a sufficient number of officials to participate in these meetings. Even more importantly, there must be consistent representation at related meetings to ensure continuity in policy and approach. This is important to establish constructive relationships with

ASEAN counterparts and to build the country's institutional memory regarding a given area of ASEAN cooperation.

1.3. The Response

Although Cambodia's membership in ASEAN has been postponed, its status as an observer in ASEAN continues. Anticipating full membership in the near future, Cambodia has begun to establish its institutional infrastructure for ASEAN.

In 1996, the Cambodian government appointed its representative to the ASEAN Economic Ministers Meeting, the AFTA Council and the Senior Economic Officials Meeting. A General Department on ASEAN, which will serve as Cambodia's National ASEAN Secretariat upon admission, was formally created within the Ministry of Foreign Affairs and International Cooperation. Although not yet formally established, ASEAN departments or units exist in the Ministry of Economy and Finance, the Ministry of Commerce, the Ministry of Industry, Mines and Energy, the Ministry of Justice, the Ministry of Information and the Ministry of Agriculture, Forestry and Fisheries. ASEAN focal points, *i.e.* specific officials, exist in most other ministries as well as in the Cabinet of the Council of Ministers.

A National AFTA Unit, chaired by Cambodia's Senior Economic Official for ASEAN, has been created by sub-decree and has convened on several occasions. Its membership consists of representatives of eight ministries and agencies.² The government also established an Internal Coordination Network (known as the ICN) to make political decisions related to ASEAN preparations and participation.³ To date, the ICN has met once,⁴ though a written request was made for the ICN to convene to endorse the Common Effective Preferential Tariffs (CEPT) inclusion list prepared by the government before its submission to ASEAN.

More recently, two informal working groups have been formed to compile a list of non-tariff barriers existing in Cambodia and to address ASEAN cooperation in the service sector. Meetings aimed at revising Cambodia's customs code and tariff nomenclature system have occurred. The ASEAN Department at the Ministry of Economy and Finance has also identified one official to be its focal point on non-tariff barriers. Formally establishing an inter-ministerial task-force on customs and tariff reform is also being discussed.

1.4. Ongoing Challenges

Looking ahead, serious questions remain regarding Cambodia's institutional capacity to handle ASEAN economic cooperation. It is not a question of interest or willingness by officials to do the work. Rather, the most pressing challenges are: 1) marshalling sufficient human resources to internalise and implement ASEAN initiatives; and 2) building inter-ministerial arrangements that can effectively and efficiently coordinate to generate policy options, develop and share information, and provide technical input to guide Cambodia's participation in ASEAN's various economic initiatives.

² The following ministries and governmental bodies are represented in the National AFTA Unit: the Ministry of Economy and Finance, the Ministry of Commerce, the Ministry of Foreign Affairs and International Cooperation, the Ministry of Planning, the Ministry of Agriculture, Forestry and Fisheries, the Ministry of Industry, Mines and Energy, the Council for the Development of Cambodia (CDC) and the National Bank of Cambodia (NBC). A representative from the Cabinet of the Council of Ministers has also attended meetings.

³ The ICN was established pursuant to Sub-Decree No. 32, dated 25 June 1996, which describes the members of the ICN and its functions.

⁴ During its initial meeting on 15 November 1996, the ICN discussed the status of preparations to date, the institutional arrangements for ASEAN affairs, a sub-decree establishing the National AFTA Unit, a strategy paper on AFTA produced by the Ministry of Economy and Finance, and visa exemptions for ASEAN nationals.

At present, the bulk of Cambodia's preparations and planning with respect to ASEAN economic cooperation is handled by a relatively small number of officials who are seriously over-worked and under-paid. Their capacity to manage Cambodia's preparations for AFTA and other more immediate areas of ASEAN economic cooperation, such as customs and services, is near its limit. However, once Cambodia joins ASEAN, it will be expected to actively participate in a host of other equally ambitious economic initiatives, such as the creation of the ASEAN Investment Area (AIA) and the development of the ASEAN Industrial Co-operation (AICO) scheme.

Although promising progress was made in 1997, the government has yet to demonstrate that it can closely and regularly coordinate on ASEAN matters. The National AFTA Unit has supervised the creation of the initial list of products to be included in AFTA. This inclusion list, which represented a major effort by the government, was submitted to ASEAN on schedule—though without official endorsement from the ICN—and compared quite favourably to the lists offered by Laos and Myanmar in terms of product coverage and speed of tariff reductions. Its thematic working groups that address non-tariff barriers and services have begun meeting, though irregularly.⁵

However, the planning process for key issues such as developing product lists for AFTA's CEPT scheme, identifying non-tariff barriers, and revising Cambodia's tariff nomenclature system, is being driven by a few highly capable officials in the government. They work without substantial or sustained support by technical experts in the relevant ministries. One potential result of this problem is that ministries and other governmental agencies may not adequately understand the dynamics and implications of implementing ASEAN economic initiatives. These officials also labour without the benefit of comprehensive, reliable economic data to provide a sound basis for policy planning. This raises the likelihood that policies are being set with incomplete information.

In many ways, these challenges simply mirror the larger difficulties facing Cambodia. Strengthening the public sector is one of Cambodia's most critical needs. It has been suggested that a civil service based on meritocracy is needed. ASEAN admission, however, will only further highlight the existing gap between the demands placed on the public sector and its capacity to respond in a coherent and informed manner.

One ongoing risk is that expediency will dictate the government's response to this problem. It takes a sustained political commitment to establish the necessary institutions to handle ASEAN affairs. Although it is sometimes easier and faster for senior officials to simply make unilateral decisions on ASEAN issues as they arise, in the long run it is imperative that institutional mechanisms and transparent decision-making procedures are created and respected. Effective integration into ASEAN requires a serious commitment to institution building in Cambodia.

2. Legal Reforms Related to ASEAN

2.1. Fundamental Challenges

When speaking about the legal implications of ASEAN membership, there are two separate questions that must be addressed: 1) what are the legal requirements for entry into ASEAN? and 2) what are the legal implications, if any, of membership?

⁵ For example, the working group on services, chaired by the deputy senior economic official, with representatives from nine ministries and agencies, has met twice. A future meeting is expected to take up the topics of tourism and cross-border services. The working group on non-tariff barriers plans to begin meeting once the temporary exclusion, sensitive and general exception lists for CEPT are drafted, a process due to be completed by late October 1997.

These two issues, however, must be seen in a larger context. Cambodia (like ASEAN's newest members) is an economy in transition, seeking to transform itself from a command-oriented system into a market-oriented system. This process requires a parallel transformation of Cambodia's legal system to provide the legal infrastructure for a market economy driven by the private sector.

Indeed, reforming Cambodia's legal system is connected more to Cambodia's larger ambitions for economic growth and development than it is to the requirements for participation in ASEAN. The need for legal reform goes beyond the minimal formal requirements of ASEAN. In truth, the long-term success of Cambodia's economic transition and growth, not to mention its ability to benefit from ASEAN membership, is linked to the complete renovation and strengthening of its legal infrastructure.

In general, ASEAN membership does not directly require Cambodia or any other member country to enact specific legal reforms. At present, there is no such thing as "ASEAN law." And harmonising the laws of the ASEAN member countries has never been a primary objective of ASEAN.⁶

This is slowly changing, however. ASEAN has always recognised that the private sector is the key to its efforts to deepen the economic integration of its member countries. The lack of common, or at least harmonised, laws creates additional risk for businesses and investment. The private sector needs a minimum amount of legal security and a maximum amount of transparency and predictability in order to operate best. Thus, ASEAN has come to realise the value, indeed necessity, of some standardisation of procedures, rules and practices.⁷ We are starting to see a gradual harmonisation of rules related to trade and investment. The main mechanism for this legal harmonisation is the creation of binding economic agreements which all ASEAN members must adopt.⁸

It is thus incorrect to say that entry into ASEAN has no legal impact on Cambodia. The expansion and deepening of ASEAN economic cooperation has a real practical effect on the development of laws in each ASEAN member country, and ASEAN membership will have serious consequences for Cambodia's law reform efforts. Once Cambodia accedes to the various ASEAN economic agreements, it will be obliged to enact domestic legislation in order to implement many of these agreements. Such domestic laws provide a legal framework for ASEAN economic cooperation. Even where ASEAN agreements contain no binding legal commitments, they can put pressure on member countries to reform laws to comply with the spirit and objectives of such agreements.

Thus, the main result of ASEAN membership may be to push Cambodia to enact more far-ranging legal reforms with even greater speed. It is also likely to encourage greater transparency in the creation, application and enforcement of its laws.

At the moment, the challenges are great. Many fundamental laws essential for commercial activities are still missing. There is no company law or law on business enterprises to govern the establishment and existence of corporations and other commercial entities. There is also no modern contract law setting out the basic rules under which people and companies can conduct business and arrange their commercial relationships. No bankruptcy law exists to

⁶ Even now, ASEAN continues to approach harmonisation of laws with great caution and hesitates to require changes to domestic laws. For example, the recent meeting of ASEAN Ministers of Agriculture and Forestry on 12 September 1997 approved a new memorandum of understanding (MoU) to protect sea turtles. However, the MoU lacks any specific binding measures to improve environmental laws in the ASEAN countries.

⁷ For example, the *ASEAN Agreement on Customs* lists as its first objective "to simplify and harmonize customs valuation, tariff nomenclature and customs procedures." (Article 1a)

⁸ ASEAN also uses other legal documents including protocols, MoUs and treaties to establish binding legal obligations of its member states.

govern the dissolution of companies and protect creditors and investors. Cambodia has no banking law to regulate the private commercial banking sector. There are no laws on intellectual property such as copyrights, patents and trademarks. No law exists regulating the insurance industry; insurance is a vital issue for any major commercial or industrial enterprise because it reduces the risks of liability or loss to a company.

A detailed discussion of these laws is beyond the scope of this paper. The purpose of listing them is to highlight current gaps in Cambodia's legal framework that tangibly relate to effective implementation of and participation in ASEAN economic initiatives. Such laws are not explicitly required by ASEAN. They are, however, absolutely essential if Cambodia is to fully benefit from its participation in ASEAN's economic initiatives such as AFTA. For example, one cannot expect major, long-term investment in Cambodia when the country lacks a company law or modern contract law.

2.2. Requirements

As mentioned above, ASEAN has few formal legal requirements for membership. Prospective member countries must adhere or accede to all ASEAN treaties, agreements and declarations, including the key ASEAN documents that define the principal goals, principles and objectives of ASEAN including the *Treaty on Amity and Cooperation in Southeast Asia* and the *Bangkok Declaration* which launched ASEAN in 1967.⁹

Joining ASEAN also means that member countries make a variety of legally binding commitments upon entry. For example, ASEAN's newest members, Laos and Myanmar, signed a *Protocol for Accession to ASEAN Agreements* as part of the admission process.

The *Protocol* obligates each new member state to accede to and implement all key ASEAN agreements related to economic matters.¹⁰ In addition, the *Protocol* requires new ASEAN members to extend most favoured nation (MFN) status and national treatment (NT) to all ASEAN members. It also requires a new member to ensure transparency in its system

⁹ In addition, ASEAN requires that new ASEAN members adhere to the *Zone of Peace, Freedom and Neutrality Declaration* (1971), the *Declaration of ASEAN Concord* (1976), the *Manila Declaration of 1987*, the *Singapore Declaration of 1992*, the *ASEAN Declaration on the South China Sea* (1992) and the *Bangkok Summit Declaration of 1995*.

¹⁰ The *Protocol on the Accession to ASEAN Agreements* obligates signatories to accede to the following agreements: *Agreement on the Establishment of the ASEAN Secretariat* (Bali 1976, as amended), *Agreement on the ASEAN Food Security Reserve* (New York 1979, as amended), *Agreement for the Establishment of a Fund for ASEAN* (Bangkok 1994), *Agreement on the Promotion and Protection of Investments* (Manila 1987, as amended), *Framework Agreement on Enhancing Economic Cooperation* (Singapore 1992, as amended), *Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area* (Singapore 1992, as amended), *ASEAN Framework Agreement on Services* (Bangkok 1995), *ASEAN Framework Agreement on Intellectual Property Cooperation* (Bangkok 1995), *Basic Agreement on the ASEAN Industrial Cooperation Scheme* (Singapore 1996), *Protocol on Dispute Settlement Mechanism* (Manila 1996) and the *ASEAN Agreement on Customs* (Phuket 1997).

In anticipation of membership, Cambodia is taking steps to have 17 ASEAN economic agreements and declarations approved by the Council of Ministers and the National Assembly. In addition to the above-mentioned agreements, these include: *Agreement on the Preferential Shortlisting of ASEAN Contractors* (Jakarta 1986), *ASEAN Petroleum Security Agreement* (Manila 1986), *Memorandum of Understanding on the ASEAN Swap Arrangements* (Kuala Lumpur 1977, as amended), *Multilateral Agreement on Commercial Rights on Non-Scheduled Services among the ASEAN* (Manila 1971), *Agreement on the Facilitation of Search of Ships in Distress and Rescue of Survivors of Ship Accidents* (Kuala Lumpur 1975) and *Agreement on the Facilitation of Search of Aircraft in Distress and Rescue of Survivors of Aircraft Accidents* (Singapore 1972). In addition, the Council of Ministers approved another four agreements covering security issues.

for trade and services by making sure that other ASEAN members are aware of all laws, regulations and rules, and any changes to them.

The *Protocol* also includes two annexes that list specific obligations regarding implementation of AFTA/CEPT and the *Framework Agreement on Services* which new members are bound to follow.

In order to ensure that new members to ASEAN quickly comply with their commitment to accede to all ASEAN agreements, declarations and treaties, ASEAN is preparing a second protocol by which the new members will accede to an additional 10 ASEAN agreements. This protocol will likely cover such issues as cooperation in energy, petroleum, security, preferences for ASEAN contractors, conservation of natural resources and the mass media.¹¹

Despite the absence of many legal requirements for ASEAN membership, implementation of the various ASEAN economic agreements will require Cambodia to revise or draft many laws and regulations. This is particularly true with respect to the implementation of AFTA/CEPT. Cambodia, like other ASEAN members, will be required to pass legislation reducing its tariffs on imports and exports as set out in its CEPT product lists according to the schedule provided in the *CEPT Agreement*.¹²

To counteract the loss of customs revenues caused by AFTA's implementation, Cambodia will be forced to restructure its tax system to broaden its tax base and reduce its current dependency on customs revenues. Although not expressly required by AFTA, tax reform will be a major area of legal reform necessitated by participation in AFTA.

Goods covered under AFTA are also entitled to more streamlined and faster customs procedures, often referred to as a "green lane" system. Establishing a "green lane" system for ASEAN imports will require new regulations.

Many of the ASEAN framework agreements, such as for services or intellectual property, do not include legally binding commitments, but they do indicate issues which will likely be addressed later in more specific binding agreements, or issues which ASEAN members are expected to address in domestic legislation.

For example, the *Framework Agreement on Services* states that ASEAN members will negotiate liberalisation of specific service sectors which will be contained in a schedule of commitments. Thus, the *Framework Agreement on Services*, though not requiring any specific reforms, does require ASEAN members to begin a process that will result in binding commitments to liberalise their service sectors. In the end, carrying out these negotiated commitments will require revisions to laws and regulations to give them legal effect. This was noted at a recent ASEAN Senior Economic Officials Meeting in Indonesia in September 1997. As a result, ASEAN is likely to draft a legally binding protocol that will include all the commitments on services made by the member states.

¹¹ A draft of this protocol was discussed at the ASEAN Senior Economic Officials Meeting held recently in Medan, Indonesia, from 8–10 September 1997 (SEOM 4/28). The need for a second protocol was raised initially by the ASEAN Secretariat, and was the first issue addressed at the SEOM 4/28.

¹² The CEPT scheme includes three basic timetables for the reduction of tariffs on products. An accelerated or "fast track" timetable exists for certain categories of goods that will require tariffs to reach the 0–5 percent range within eight years after AFTA's implementation. "Normal track" products—which includes all other goods except unprocessed agricultural products—must reach 0–5 percent tariff rates within 10 years. Sensitive unprocessed agricultural products must be phased into the CEPT scheme within 13 years of implementation. Some products included on a country's sensitive list, general exceptions list and a list of very sensitive agricultural products, pursuant to country-specific negotiations, will not follow this schedule. New ASEAN members have tariff reduction timetables that reflect the fact that they joined ASEAN on a later date, but the total time period for their tariff reductions is the same as that of the original members.

Other ASEAN agreements contain specific conditions and commitments that are legally binding. For example, under the *ASEAN Agreement on Customs*, member states must adopt the ASEAN Harmonised Tariff Nomenclature and implement the customs valuation system contained in the General Agreement on Tariffs and Trade (GATT). Although implied by the *CEPT Agreement*, the *ASEAN Agreement on Customs* explicitly directs member states to implement a faster “green lane” customs system for CEPT products. Such reforms to Cambodia’s customs administration and procedures will require changes to its laws and regulations. More broadly, a new customs code is needed to comply with the *ASEAN Agreement on Customs*.

2.3. The Response

In the past few years, Cambodia has actively pursued legal reforms in connection with the liberalisation and modernisation of its economy. This trend is likely to accelerate once Cambodia joins ASEAN. On the eve of ASEAN membership, it might be useful to review the key economic-related legal reforms to date and to preview upcoming reforms.

Cambodia has already enacted an investment law in 1994 and laws establishing a commercial register and a chamber of commerce in 1995. A law on the organisation and conduct of the National Bank of Cambodia was passed in 1996.

Advanced drafts of numerous laws now exist. For example, laws on business organisations, commercial arbitration, banking, copyright, bankruptcy, contract and product liability have been drafted. A sub-decree on investment will be approved soon to provide clearer rules and procedures for investment in Cambodia. A working group has been organised to begin drafting a new customs code and new tariff nomenclature to comply with ASEAN requirements. An insurance law has been forwarded to the National Assembly for consideration.

In order to better understand the legal commitments that will be expected or required once negotiations begin on services, the government has also organised an informal working group on services comprised of officials from the Ministry of Economy and Finance, the Ministry of Commerce, the Ministry of Tourism, the Ministry of Public Works, the Ministry of Industry, Mines and Energy, the Ministry of Posts and Telecommunications, the State Secretariat for Civil Aviation and the National Bank of Cambodia.

2.4. Ongoing Challenges

Most of the legal reforms related to ASEAN membership have yet to be accomplished. However, it must be remembered that law reform is a long-term process. It never really ends. Laws must continuously be revised, amended and strengthened.

There are certain key challenges facing Cambodia regarding legal reform generally, and reforms associated with ASEAN in particular. The biggest challenge for law reform in Cambodia is the same main challenge with respect to institutional adjustments for ASEAN: weak human resources.

There are very few trained lawyers to advise the government on the legal implications of ASEAN membership and participation in the various ASEAN economic initiatives. As was noted above, ASEAN conducts its business mainly through meetings. Over time these meetings produce agreements which often include binding commitments that each member must implement. There are not enough officials capable of negotiating and drafting agreements in English. This puts Cambodia at a great disadvantage in its participation in ASEAN.

Every word in an ASEAN agreement is negotiated. Each agreement is carefully drafted to define the legal commitments that the member countries will carry out. And in the process of negotiating and finalising an agreement, each member state seeks to gain the most benefit by

ensuring that its positions and ideas are included in the language of the final agreement. Each member uses the negotiations to protect vital interests through the wording of agreements. To maximise its benefits during this process and to ensure its views are part of the final agreement, Cambodia will need strong negotiators and officials who can participate in and closely follow the policy debate and the drafting process.

Other more long-term challenges involve the ability and willingness to apply new laws in a consistent, transparent and speedy manner. Judges must be trained to familiarise them with new laws as they are enacted. Indeed, many judges never receive copies of new laws. In general, the court system must be significantly strengthened to properly handle the large number of new laws that will be created in the next few years.

3. Conclusion

The purpose of this paper has been two-fold: to summarise the key institutional and legal implications of ASEAN membership for Cambodia, while highlighting some of the most important challenges facing Cambodia as it plans for entry into ASEAN. There is no doubt that much work remains to be done.

In the end, the key to Cambodia's success in ASEAN rests with its people, both its officials and its citizens. Building and strengthening Cambodia's institutional and legal infrastructure requires the commitment, energy and participation of everyone. There must be a willingness to cooperate in decision-making, to share information and ideas, and to identify Cambodia's priority areas of ASEAN cooperation to pursue.

The stakes are high. With the globalisation of the world economy a fact of life, countries are locked in an unending competition for trade and investment. And in many ways, the economic success of countries in transition such as Cambodia is closely connected to their ability to build comparative advantages in their institutional and legal frameworks. ASEAN membership provides one more reason why Cambodia should address these issues sooner rather than later.

Chapter Three

Membership in ASEAN: Public Finance and Tax Reform in Cambodia

Kun Nhem¹

1. Introduction

One of the characteristics of the post-Cold War period is the process of regional integration. This tendency has affected many regions in the world, including Southeast Asia. Evidence proving this trend is found in the political and economic reforms in the so-called Southeast Asian Transitional Economies (SEATEs—Cambodia, Laos, Vietnam and Myanmar), and in the enlargement of the Association of Southeast Asian Nations (ASEAN). Cambodia is now the only country in Southeast Asia which remains outside this regional group, but it is likely to be granted membership in ASEAN in the near future.

The purpose of this paper is to review the current macro-economic performance of Cambodia, focusing on fiscal and financial aspects, in order to examine possible challenges stemming from Cambodia's participation in the ASEAN Free Trade Area (AFTA), to look at the reforms undertaken by the government in the area of customs and taxation, and to identify options and emerging needs for the government for Cambodia's beneficial participation in ASEAN and AFTA.

2. Cambodia's Macro-Economic Performance

Cambodia has made significant progress to date in stabilising the economy and maintaining economic growth. Macro-economic development in the past few years has been impressive: GDP grew at an average annual rate of about 6 percent from 1991 to 1995; inflation, which averaged about 140 percent per year during the 1990–92 period, was reduced to 3.5 percent in 1995; and budget revenue as a share of GDP doubled during the 1991–95 period.

Under policy reform, prices were deregulated, a major customs reform took place and new tax measures were introduced, a two-tier banking system has been initiated, the exchange rate has been liberalised, most non-tariff barriers have been removed, and tariffs have been reduced and streamlined. Due to these reforms, Cambodia's economic and trade regimes are favourable.

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Table 3.1. Macro-Economic Indicators

	1991	1992	1993	1994	1995	1996
Real GDP (percentage change)	7.6	7.0	3.9	5.2	7.6	6.5
GDP per capita (\$)	-	210	230	240	260	287
Production share (% of GDP):						
Agriculture	51.9	49.3	46.5	45.2	44.6	42.7
Industry	15.0	16.3	18.0	18.3	18.7	19.9
Services	33.1	34.4	35.5	36.5	36.7	37.4
Exchange rate (riels per \$)	703	1,253	2,470	2,585	2,700	2,750

Source: World Bank, *East Asia and Pacific Region, 1995*

Undoubtedly, recent economic growth largely reflected a recovery from the past, as well as the benefits of macro-economic stability and economic liberalisation. At the same time, these remarkable achievements have been supported by foreign aid and concessional loans from both bilateral and multilateral sources. Cambodia is now at a crossroads. From these initial achievements, the country must make a transition towards sustainable development.

Fiscal discipline has been instrumental in achieving macro-economic stability. The government has contained the budget deficit and prevented bank financing of the budget. However, the fiscal situation in 1996–97 remained weak, despite the implementation of new tax measures introduced in 1995, as well as the initiation of pre-shipment import inspections. In 1996, total budget revenue amounted to 9.1 percent of GDP compared with the budget target of 9.8 percent. It is important to note that the revenue-GDP ratio has been flat during the last two years, following a significant improvement in 1994.

There are several main reasons for this weak revenue effort. The two major causes are pervasive tax/duty exemptions and a weak tax/duty collection capacity. Tax exemptions granted under the Investment Law to investors have significantly eroded the tax base. According to data provided by the Cambodia Investment Board (CIB), the approval of duty exemption to investors in 1996 amounted to \$732.23 million (Table 3.2). This is far more than the customs duties collected per year, which amounted to around \$148 million.

Table 3.2. Monthly Approvals of Duty Exemption, 1996 (millions of \$)

	Capital goods	Raw materials	Total
January	28.88	25.62	54.50
February	17.16	15.67	32.83
March	17.11	6.41	23.54
April	11.96	20.07	32.03
May	27.38	27.42	54.80
June	14.02	61.48	75.51
July	24.12	48.96	73.08
August	54.68	19.35	74.03
September	52.46	27.46	79.92
October	20.32	10.86	31.18
November	38.62	11.05	49.68
December	65.49	85.66	151.15
Total	372.21	360.01	732.23

Source: Cambodia Investment Board

Moreover, additional *ad hoc* exemptions granted to several export (such as rubber, timber and sawn wood) and import (luxury automobiles) items exacerbated the revenue situation.

Table 3.3. Budget Revenue and Expenditure (percentage of GDP)

	1991	1992	1993	1994	1995	1996
Budget revenue	4.4	6.2	5.4	6.9	8.9	9.1
Tax	2.3	4.4	4.3	5.9	6.2	6.5
Non-tax	2.1	1.8	1.0	3.7	2.7	2.6
Budget expenditure	7.8	9.8	11.2	16.5	16.7	16.4
Current expenditure	7.4	9.5	6.9	11.0	9.6	9.9
Capital expenditure	0.4	0.3	4.3	5.5	7.1	6.5
Current budget deficit	-3.0	-3.3	-1.5	-1.4	-0.6	-0.8
Overall budget deficit	-3.4	-3.6	-5.9	-6.8	-7.7	-7.3

There were also shortfalls in the collection of non-tax revenue, which have been limited to 2 to 3 percent of GDP, in particular because of difficulties in collecting the full value of forestry revenue.

Table 3.4. Revenue Efforts, 1995-96 (percentage of GDP)

	Tax revenue	Non-tax rev.	Total revenue
Cambodia	7.1	2.7	9.8
Laos	10.8	2.5	13.3
Vietnam	19.6	3.4	23.0

Source: World Bank, *Cambodia: Progress in Recovery and Reform, 1997*

In general, Cambodia's budget revenue-GDP ratio (which stood at 9.1 percent in 1996) is very low by international standards. The current tax effort (6.5 percent of GDP) is roughly

half of the average for low-income countries (Table 3.4). Total budget revenue has not covered current expenditures. External grants and concessional loans have financed the current budget deficit and almost all capital expenditures.

Table 3.5. Cambodia: Tax Revenue Structure (percentage of GDP)

	Tax %	Income tax			Domestic tax on goods and services			International trade tax		Prop. taxes	Other taxes	
		Total	Individ.	Corp.	Total	Sales	Excise	Total	Import Export			
1994	5.90	0.30	0.00	0.20	1.20	1.10	0.10	4.20	3.90	0.20	0.00	0.30
1995	6.19	0.26	0.02	0.24	1.20	1.07	1.13	4.42	4.18	0.24	0.00	0.31
1996	6.52	0.26	0.03	0.23	1.88	1.19	0.69	4.18	4.80	0.10	0.00	0.20

Source: World Bank, *Cambodia: From Recovery to Sustained Development, 1996*; *Cambodia: Progress in Recovery and Reform, 1997*

Strengthening the tax and customs administration in the past few years has improved revenue mobilisation. Total tax revenue as a percentage of GDP had increased from 5.90 percent in 1994 to 6.52 percent of GDP in 1996 (Table 3.5). The introduction of new forms of taxation has also made a contribution to total tax revenue.

Cambodia has made significant progress in expenditure management since the adoption of the Budget Law in 1993. Progress has also been made in establishing audit and inspection procedures, treasury cash management and accounting. Recent progress includes: assigning financial controllers to each ministry, establishing a system of direct payments by the treasury for the procurement of items over a specified amount, establishing competitive procedures through the Public Procurement Department of the Ministry of Economy and Finance, and adopting a public accounting sub-decree to avoid having unpaid payment orders carry over into the next fiscal year. Through these steps and measures, the government has succeeded in containing current expenditures at around 10 percent of GDP. However, the high level of defence and security expenditures has resulted in limited scope for civilian expenditures.

Cambodia spends about 2 percent of its GDP on health and education, compared with an average of 5 percent of GDP for other low-income countries. At the same time, Cambodia's level of expenditure for defence and security is much more higher (two to three times as

Table 3.6. Current Expenditure (by sector)

	1994		1995		1996		1997	
	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual
	(billions of riels)							
Defence / security	283.2	391.5	299.0	421.2	392.3	400.7	383.5	-
Education	63.8	61.0	73.4	72.4	83.8	80.5	87.9	-
Health	42.4	30.0	36.2	26.1	60.4	44.0	60.7	-
Agriculture / rural dev.	14.9	12.4	17.2	15.3	20.8	18.7	24.4	-
Total	585.6	662.3	652.7	731.7	751.0	793.9	870.0	-
	(percentage of GDP)							
Defence / security	48.4	59.1	45.8	57.6	52.2	50.5	44.1	-
Education	10.9	9.2	11.3	9.9	11.2	10.1	10.1	-
Health	7.2	4.5	5.5	3.6	8.0	5.5	7.0	-
Agriculture / rural dev.	2.5	1.9	2.6	2.1	2.8	2.4	2.8	-
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	-

Source: World Bank, *Cambodia: Progress in Recovery and Reform, 1997*

much). The composition of spending therefore needs to be changed to support development priorities—expenditure allocation needs to be significantly re-addressed towards social sectors and economic infrastructure. The government recognises the need for such expenditure re-orientation, and it has committed itself to achieve this through the *First Socio-Economic Development Plan, 1996-2000*, and the *Three-Year Rolling Public Investment Programme (PIP), 1996-98*. The objective is to increase expenditure on health and education to 5 percent of GDP from the current 2 percent by the year 2000, and to reduce defence and security spending to 3.5 percent of GDP from the current 5 percent. To achieve these objectives, the government will first need to strengthen capacity to monitor and control budgetary expenditures through full implementation of the recently introduced measures such as the assignment of financial controllers, direct payment systems and competitive bidding procedures.

Cambodia's balance of payments need to be viewed with consideration of many factors such as illegal exports, tariff-exempt imports, and the rough estimates of inflows of foreign direct investment (FDI). Domestic exports (including re-exports) increased at the robust rate of 11 percent in 1996, thanks to the generalised system of preference (GSP) system granted by 26 countries to Cambodia. The current account deficit narrowed slightly to 15.6 percent of GDP. Official transfers declined by \$50 million compared with 1995, and concessional loan inflows remain at the 1995 level.

3. Participation in AFTA and its Challenges

Cambodia is now an observer in ASEAN, and the government expects the country to become a full member of this regional organisation in the near future. As member of ASEAN, Cambodia will have an obligation to accede to all ASEAN economic agreements. With regard to AFTA, Cambodia will need to implement the *Framework Agreement on Common Effective Preferential Tariff (CEPT) for the ASEAN Free Trade Area*. It is expected that Cambodia, like other new members of ASEAN (Vietnam, Laos and Myanmar), will have a 10-year time frame for implementing the CEPT scheme for AFTA.

The main objective of AFTA is to further liberalise intra-ASEAN trade by reducing customs tariffs and eliminating non-tariff barriers. Under CEPT for AFTA, member-states also agree to accelerate cooperation in other important areas, including the harmonisation of tariff nomenclature, customs evaluations and procedures, mutual recognition of product certification, harmonisation of standards, and the simplification of trade- and investment-related procedures. It is understood that in response to these requirements, Cambodia will need to readjust its legal framework to be consistent with those prevailing in the ASEAN countries. The implications of joining ASEAN, and especially AFTA, are multi-dimensional. And, unfortunately, there has so far been no comprehensive study on this matter.

However, potentially the greatest challenges of Cambodia's participation in AFTA are the impacts this will have on tariff changes to budget revenue, trade and balance of payments, investment flows and manufacturing.

Cambodia had hoped to become part of the ASEAN family along with Laos and Myanmar, whose membership was accepted in July 1997. Preparation for full membership began in 1996, both in organisational and technical aspects. On the technical side of participation in AFTA, Cambodia will have to prepare four product lists: an inclusion list, a temporary exclusion list, a sensitive list, and a general exception list. The National AFTA Unit, which has the ASEAN Department of the Ministry of Economy and Finance as its focal point, prepared the initial package for the inclusion list to be included in the CEPT scheme. Based on the eight-digit level of the Harmonised System, Cambodia had included 3,149 items (47 percent of all tariff lines) in the inclusion list. This initial package was submitted to the third Senior Economic Officials Meeting of the 28th ASEAN Economic Meeting, held from 22 to 24 July

1997 in Indonesia, and was expected to be implemented from 1 January 1998 (since Cambodia expected to join ASEAN in July 1997).

Table 3.7. Initial Package of Tariff Lines on Inclusion List

	Number of tariff lines on inclusion list	Percentage of total tariff lines
Cambodia	3,149	47
Laos	533	15
Myanmar	2,333	43
Vietnam	857	28

In view of Cambodia's tariff structure, which has bands of 0-percent, 7 percent, 15-percent, 35-percent, 50-percent and 100-percent rates, the average tariff rate in Cambodia is relatively low compared to those in other ASEAN countries before the im-

plementation of AFTA. According to current tariff nomenclature (mixed four- and six-digit Harmonised System), the four major tariff bands—7-percent, 15-percent, 35-percent and 50-percent—apply to over 93 percent of tariff lines. Eighty percent of the existing 2,305 tariff lines fall within the 0–20 percent range, while the remaining 462 products have tariff rates of more than 20 percent. The average tariff rate is estimated to be 14.5 percent.

3.1. Methodology Used in the Preparation of the CEPT Product List

Recognising the importance of this task (since participation in AFTA will have a multi-dimensional impact on the national economy), the National AFTA Unit members carefully discussed the method of preparing the inclusion list. Based on political guidance, the CEPT/AFTA principles, and Cambodia's existing trade, investment and production situation, the following principles were adopted as the basis for preparing the CEPT product lists:

- Participation in AFTA means that the trade and economic regime will become further liberalised and more open. As a result of tariff reductions and the elimination of non-tariff barriers, and in combination with comparative advantages, Cambodia can attract more FDI and strengthen its competitive advantage. ASEAN sees CEPT/AFTA as the cornerstone of the second wave of FDI inflows in the Southeast Asia region. Countries that slow their economic and trade liberalisation will miss this opportunity. In this sense, the faster the implementation of CEPT/AFTA takes place, the better for Cambodia. Cambodia has already been feeling the effects of “reverse investment” as a result of political tension in the last few months.
- Participation in AFTA will create wider market access and expand production and trade in general. In terms of external trade, geographic ties would not allow Cambodia to remain outside AFTA (an enclave situation), because keeping high tariff rates relative to neighbouring countries may result in increased smuggling.
- Two important criteria have been taken into consideration in identifying products to be added to the inclusion list: the tariff rates themselves and the volume of traded goods. As indicated above, Cambodia's tariff rates are relatively low, so items which have tariff rates of 0 percent, 7 percent, and 15 percent, and some of those at 35 percent should initially be included as much as possible on the inclusion list. Other commodities with higher tariff rates (over 35 percent) could also be included on the inclusion list if the volume of trade of such goods is not high (in which case, customs duties collected from these categories of goods is also small, and subsequently has little impact on government revenue). Means of production (*i.e.* industrial and agricultural equipment, manufacturing machinery and raw materials) also need to have lower tariff rates (most of these already enjoy duty-exempt import status). Special attention needs to be given to the agricultural and manufacturing sectors, and especially to small- and medium-sized enterprises (SMEs).

Based on these principles and criteria, the National AFTA Unit prepared an initial package for the inclusion list with 3,149 tariff lines. The composition of tariff rates is as follows: of

those 3,149 tariff lines, 2,584 have rates under 20 percent. According to the tentative tariff reduction schedule of the inclusion list for Cambodia, these 2,584 tariff lines will keep their existing tariff rates until the year 2001 (assuming that Cambodia becomes a full member of ASEAN in 1998, the tariff reduction programme will start from 1 January 1999). In the early stage of tariff reduction (1999), the effects will only be on items which have tariff rates of 35 percent (436 tariff lines), 40 percent (two tariff lines) and 50 percent (118 tariff lines). In 1999, the items on the inclusion list with tariff rates of 35 percent, 40 percent and 50 percent will be reduced to 20 percent, 30 percent and 35 percent respectively (Tables 3.8, 3.9 and 3.10). The initial assessment of tariff reductions for these three tariff bands therefore will be on average around 13.3 points (32.6 percent) from existing tariff rates. From this, budget revenue changes can be calculated. However, we need accurate trade statistics for at least three to four years in order to make a projection of trade for 1999, and we also need to study the trends of trade (including possible trade diversion) between Cambodia and ASEAN and Cambodia and non-ASEAN countries.

Table 3.8. Tariff Lines on the Inclusion List

Base Rate	Number of tariff lines
0.0 percent	195
0.3 percent	3
7.0 percent	1,300
10.0 percent	14
15.0 percent	1,072
20.0 percent	9
35.0 percent	436
40.0 percent	2
50.0 percent	118
Total	3,149

3.2. Impact of Reductions on Government Revenue

Based on preliminary assessments of the tariff reductions and schedule for Cambodia, the first effect on government revenue will be the reduction of 556 tariff lines on the inclusion list with tariff rates at 35, 40 and 50 percent. The delay to membership in ASEAN will

Table 3.9. Sample Tariff Reduction Schedule of the CEPT Scheme for Cambodia (percentages)^a

Base rate	Track ^b	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
35 percent	F	20		15		10		7	0-5			
	N	20			15		15		10		7	0-5
40 percent	F	30			20		10		0-5			
	N	30			20		20		10		7	0-5
50 percent	F	30			20			10	0-5			
	N	40			30		20		10		7	0-5

^a Only tariff lines with 35-, 40- and 50-percent tariff rates will be reduced from 1999; ^b F = fast, N = normal

Table 3.10. Average Tariff Reduction of Three Tariff Bands on the Inclusion List (sample schedule for 1999)

Base rate	Initial offer (1999)	Cut in scale	Percentage cut
35 percent	20 percent	15 points	42.8
40 percent	30 percent	10 points	25.0
50 percent	35 percent	15 points	30.0
Total tariff reduction		40 points	97.8
Average tariff reduction		13.3 points	32.6

on revenue in the short-term will be minimal, and the gov-

ernment will have time to find other sources of income to compensate for the loss of customs duty under the CEPT scheme.

4. Tax Reform

It is clear that implementation of CEPT/AFTA will have an impact first of all on the government budget, especially in the short and medium term. Thus, tariff reductions should be carried out in conjunction with reforms to support the budget. There is no alternative other than

to carry out tax reform to increase the domestic tax base, to enhance public resource mobilisation, and to further deepen and widen reform in other sectors in order to strengthen the economic system as a whole.

With regard to enhancing revenue mobilisation, the government has been carrying out a medium-term tax reform strategy. According to this strategy, the government has adopted the new Taxation Law (January 1997), which includes important revenue-enhancing as well as equity-enhancing provisions. The main revenue-enhancing provisions include:

- Levying a turnover tax on the first sale after importation (previously exempt);
- Broadening the coverage of the excise duties on automobiles, international air travel, and international telecommunication services;
- Introducing taxes on interest and dividends;
- Strengthening the application of a minimum tax on enterprises, including those granted tax holidays under the Investment Law; applying a 30-percent profit tax rate for oil and gas production-sharing contracts, and for exploiting natural resources, including timber, ores, gas and precious stones;
- Extending coverage of taxes on salaries to government employees, elected officials and employees of NGOs;
- Introducing the withholding of taxes; and
- Replacing taxes on turnover and consumption with a value-added tax (VAT) for the 600 largest taxpayers (from 1 January 1998), and extending it gradually.

Among the measures above, eliminating the exemption of turnover tax on the first sale after importation would have significant revenue-boosting effect, estimated at roughly 30 billion riels on an annual basis (0.3 percent of GDP). The introduction of VAT at a single rate of 10 percent would be revenue-enhancing, as a significant amount of current turnover tax is collected in the form of a consumption tax at a standard rate of 4 percent. It is important to note that VAT would be initially imposed on large taxpayers (*i.e.* import/export firms and investment enterprises). At the same time, the effect of VAT on small-scale enterprises outside the VAT system would be minimised by reducing the consumption (turnover) tax rate to 2 percent from the current 4 percent.

With regard to equity-enhancing provisions, the following measures are on track:

- Income from the sale of agricultural outputs by a person who is not a large taxpayer will be exempt from profit tax;
- Dividends paid to domestic and foreign shareholders will be subject to a withholding tax;
- Medical services, public transportation, primary financial and insurance services and public interest non-profit activities will be exempt from VAT.

Based on these measures, the effect of the introduction of new taxes will be minimal on some sectoral small-scale enterprises and on social related activities.

In connection with customs revenue, it is important to note that a very large share of total tariff revenue is derived from a relatively small number of goods. Based on six-digit level of the Harmonised System, 28 tariff lines cover more than 70 percent of total duty revenue. The approach is clear: to keep those categories of tariff lines on the temporary exclusion list, or even to keep some of them in the general exclusion list.

4.1. Effects on the Exchange Rate

Reducing trade barriers (by tariff reduction and the elimination of non-tariff barriers) will increase the demand for imports, and hence for foreign exchange, putting upward pressure on the riel. At the same time, reducing trade barriers will increase riel earnings from export activities, because exporters will endeavour to increase exports and this will subsequently increase the supply of foreign exchange, tending to depress the value of the

Table 3.11. Cambodia, Laos, Myanmar and Vietnam's Trade with ASEAN (millions of dollars)

	Cambodia		Laos		Myanmar		Vietnam	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
Trade with ASEAN	1,057	199	436	73	1,070	312	3,027	633
Total world trade	1,542	265	564	348	2,166	936	11,586	5,471
ASEAN share (%)	68.6	58.2	77.3	21.0	67.3	25.7	26.1	11.6

Source: IMF, *ASEAN Materials and Documents, 1996*

riel. The net effect depends on a number of factors, including the trade balance and the elasticities of imports and exports.

4.2. CEPT/AFTA—Impact on Balance of Payments

Participation in AFTA will gradually change the trade structure of Cambodia, as the ASEAN countries are the major trading partners of Cambodia. A large share of Cambodia's external trade falls within ASEAN. In 1995, Cambodia imports from the ASEAN-6 amounted to \$1,057 million, 68.6 percent of total imports. At the same time, Cambodia's exports to the ASEAN-6 amounted to \$119 million. These figures reflect a large trade deficit with ASEAN, and that Cambodia's trade is mainly intra-ASEAN. Myanmar and Laos, the newest members of ASEAN, also experienced the same picture in 1995; over 68 percent and 77 percent respectively of their imports were from ASEAN. At present, the effects

Table 3.12. Structure of Cambodia's Trade with the ASEAN-6 (millions of dollars)

	Imports	Exports
Brunei	-	-
Indonesia	55	2
Malaysia	84	13
Philippines	1	-
Singapore	550	38
Thailand	367	146
Total	1,057	199

Source: IMF, *ASEAN Materials and Documents, 1996*

of AFTA are somewhat muted on the other ASEAN member countries (with the exception of Laos, Myanmar and Vietnam), because their intra-ASEAN trade comprises a relatively small percentage of their total trade (in 1995, intra-ASEAN trade accounted for about 20 percent of total trade of most ASEAN countries).

5. Summary

Cambodia is one of the poorest countries in Southeast Asia. The major sector of the economy is agriculture. Industry is still in its infancy. Cambodia lags far behind many other Southeast Asian countries in various economic, social and political aspects.

In the late 1980s and early 1990s, Cambodian society was characterised by the political and economic transition from a single-party system and command economy to a multi-party system and market-oriented economy. After 1993, under accelerated reform programmes, Cambodia has made a commitment to integrate its economy into the regional and global economies. Membership in ASEAN is the priority in such an integration process.

Macro-economic stability has been maintained, and considerable economic growth rates have been achieved in the past few years. These achievements have laid the foundation for sustained economic development, which in turn enables the country to better face the opportunities and challenges that lie ahead in the context of joining ASEAN and in active participation in AFTA.

Membership in ASEAN will without doubt give Cambodia access to a large and dynamic regional market. However, tariff reductions under CEPT/AFTA may lead to immediate costs to the country, first of all in the deterioration of government revenue.

In the short term, the low level of industry and manufacturing, as well as low productivity in the agricultural sector, will limit the country's ability to benefit effectively from reciprocal concessions offered under the CEPT/AFTA principles. This will probably be reflected in the limited scope of Cambodia's exports in ASEAN, and as a result to a negative balance of trade within ASEAN.

Cambodia's long-term external competitiveness depends critically on the impact of domestic policy initiatives. The utmost priority here is the overall need for political stability and the continuation of the present macro-economic and structural reform programme. The tariff reductions to be implemented under the CEPT scheme should be viewed in conjunction with specific sectoral development (in manufacturing, agriculture and the service sector) and with comprehensive tax reform measures, which should compensate for or substitute revenue deterioration caused from tariff reductions.

The transition has not yet been completed in either a political or economic sense. The integration process, which is being undertaken back-to-back with the transition, will thus be sometimes difficult and painful.

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Chapter Four

Cambodia: Strengthening the Foundation for Trade and Industrial Development

James Robetson & Harold Pohoresky¹

1. Introduction

The main focus of this conference concerns the ongoing process of Cambodia's integration with the regional and world economies. A potentially important dimension of this is the implementation of the ASEAN Free Trade Area (AFTA). In this conference paper, we attempt to contribute to these discussions in two areas. In the next section we present a detailed assessment of Cambodia's recent trade performance. We were fortunate to have had access to detailed data from the Customs Department for 1995 and 1996, and this has permitted more detailed analysis than has been available previously. The third section addresses key issues in designing policies for implementing AFTA.

The material in this conference paper is drawn from a draft final report prepared for the government of Cambodia and the Asian Development Bank (ADB). That draft final report was prepared as part of an ADB-funded technical assistance project executed by the Ministry of Commerce and the Ministry of Industry, Mines and Energy.

It should be noted that these ministries and the ADB are still reviewing the draft final report and revisions will be made in the near future.² Therefore, it should be stressed more strongly than is usually the case that the views and opinions expressed in this paper are those of the authors alone. These views should not be attributed to any person or agency of the government of Cambodia or to the ADB.

2. Review of Trade Performance

There is a great deal of useful information about the underlying strengths and weaknesses of the economy that can be gained from a country's observed trade performance. For example, assessment of a country's areas of comparative advantage requires detailed trade data. In addition, trade patterns can also provide important insights into the effects of prevailing trade

¹ James Robertson and Harold Pohoresky prepared the material on which this paper is based as part of an ADB-funded report on technical assistance for the Cambodian government. The views expressed in this paper are those of the authors alone.

² The final report was presented to the Cambodian government and the ADB in 1998 under the title *Cambodia: Strengthening the Foundation for Trade and Industrial Development*.

policies. As a result, this paper devotes considerable attention to recent trade performance and the analysis of these patterns.

Trade data

The generation and dissemination of trade data is an issue that warrants the attention of policy-makers. The necessary data are being collected, but adequate systems have not been established that would permit these data to be processed and made readily available. Developing systems that would produce up-to-date trade data would not be difficult and would significantly enhance the ability of officials throughout the Cambodian government to better understand and monitor economic developments. This would also allow for better economic analysis by both the public and private sectors.

We would like to stress that this project has indeed been fortunate to have had access to recent detailed trade data from the Customs Department. As a result, substantial amounts of the trade data presented in this paper have not been available previously. However, because we have been working with essentially “raw” data, a great deal of time and effort has been devoted to processing these data.

For example, the customs data obtained included data files of each type of good traded, classified by Harmonised System tariff codes, and separate data files for each transaction (which often included many types of goods). These separate files had to be merged and reconciled, and transformed from Harmonised System tariff codes to Standard International Trade Classification (SITC) classifications. (SITC classification permits more sensible aggregation of trade data, and was necessary for the analysis of comparative advantage.)

It should be noted that the data presented here have been converted to dollars using the exchange rates current at the time that the trade transaction took place. These rates are available in the customs data system.

There are a number of trade data issues that have arisen during this project and these are discussed at the end of this paper. Among these issues are what may be a significant discrepancy between the customs data and aggregate trade data reported by agencies such as the World Bank and the International Monetary Fund (IMF).

2.1. Trade Data—Overview of Broad Patterns

There are three aspects of trade—imports, exports and re-exports. Re-exports play an unusually important role in trade in Cambodia mainly because of the revenue that they generate and because of the issues related to regional integration that arise.

Imports

There was a modest 7-percent decrease in total imports between 1995 and 1996 (Table 4.1). This is due mainly to the sharp decline in imports of SITC-9, which is ordinarily a miscellaneous “catch-all” category. However, as will be shown below, in this case SITC-9 is comprised primarily of gold.

In other respects, there was general consistency in the pattern of imports between 1995 and 1996. Roughly two-thirds of imports were for petroleum products (SITC-3), transport vehicles and machinery (SITC-7) and basic manufactured goods (SITC-6).

It is also worth noting that relatively small shares of imports were devoted to basic consumption goods such as food, beverages and edible oils. It is not certain whether this was due to trade barriers, such as protective barriers intended to subsidise domestic production, or was simply a reflection of the economy’s ability to meet these needs relatively efficiently.

Table 4.1. Import Patterns, 1995-96 (millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
0	Food and live animals	77.11	7	70.06	7	-9
1	Beverages and tobacco	41.77	4	46.55	5	11
2	Crude materials, excluding fuels	24.44	2	29.79	3	22
3	Mineral fuels, etc	127.00	12	142.70	14	12
4	Animal and vegetable oil and fat	3.79	0	6.67	1	76
5	Chemicals and related products	57.81	5	75.23	8	30
6	Basic manufactures	161.95	15	197.01	20	22
7	Machinery and transport equip.	249.75	23	341.47	34	37
8	Misc. manufactured goods	45.92	4	51.15	5	11
9	Goods not classed by kind	285.90	27	39.98	4	-86
	Total	1,075.43	100	1,000.60	100	-7

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

Exports

There are currently two broad areas of export activity, crude materials (SITC-2), which includes rubber and wood, and SITC-8, which includes garments (Table 4.2). Rubber and wood have been traditional exports, and the recent rapid growth in garment exports is now well known.

Comparing the distribution of exports between 1995 and 1996, it is interesting that there was a significant increase in the share of exports falling under SITC-6—basic manufactures. This reflects increases in some types of wood manufactured goods, as well as growth in some types of garments.

The data also reflect a significant increase in exports falling under SITC-9, which again is mainly due to exports of gold.

Table 4.2. Export Patterns, 1995-96 (millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
0	Food and live animals	7.03	5	5.64	3	-20
1	Beverages and tobacco	3.42	2	6.52	4	91
2	Crude materials, excluding fuels	97.33	62	75.24	46	-23
3	Mineral fuels, etc	0.00	0	0.06	0	n.a.
4	Animal and vegetable oil and fat	0.00	0	0.00	0	n.a.
5	Chemicals and related products	0.59	0	0.19	0	-67
6	Basic manufactures	12.68	8	18.22	11	44
7	Machinery and transport equip.	6.07	4	6.29	4	4
8	Misc. manufactured goods	29.46	19	29.12	18	0
9	Goods not classed by kind	0.00	0	21.91	13	n.a.
	Total	156.56	100	163.20	100	4

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional; SITC-8 has been adjusted to exclude Harmonised System 49.07, which corresponds to exports of currency

Re-exports

This brings us to Cambodia's re-exports. All (or virtually all) of this trade entails imports of goods destined for Vietnamese markets. This trade is essentially informal and is noteworthy because it is semi-official yet still generates substantial revenues for the government.

A large proportion of re-exports falls under SITC-1, beverages and tobacco. The only other significant area of re-export activity is SITC-7, which consists mainly of motorcycles.

Little is known about the extent of "re-exports" taking place outside of these channels. It is clear that the border with Vietnam is porous, including as it does many small tributaries of the Mekong River as well as considerable stretches of relatively rural, forested land. A number of business people, including traders in Cambodia as well as in Vietnam, believe that there

Table 4.3. Re-Export Patterns, 1995-96 (millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
0	Food and live animals	0.01	0	0.02	0	190
1	Beverages and tobacco	205.14	82	205.41	89	0
2	Crude materials, excluding fuels	0.02	0	0.00	0	-100
3	Mineral fuels, etc	0.00	0	0.00	0	n.a.
4	Animal and vegetable oil and fat	0.00	0	0.00	0	n.a.
5	Chemicals and related products	0.01	0	0.11	0	1,031
6	Basic manufactures	0.00	0	0.00	0	n.a.
7	Machinery and transport equip.	46.08	18	24.77	11	-46
8	Misc. manufactured goods	0.00	0	0.00	0	-100
9	Goods not classed by kind	0.00	0	0.00	0	n.a.
	Total	251.25	100	230.31	100	-8

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

is considerably more re-export activity than is reflected in official figures. There is also a general belief that there is a great deal of informal trade taking place between Thailand and Cambodia. (No opinions were obtained regarding informal trade with Laos.)

Leakage into local markets

Since re-exports are informal, they are subject to lower than normal duties. There is no documentary basis to determine the extent to which these goods are actually moved to Vietnam. There is undoubtedly a strong incentive to divert some of the goods intended for re-export towards local sales. Indeed, it is understood that one of the rationales for establishing reduced duties is to account for diversion.

Detailed data for imports raise some questions about the extent of leakage into the domestic market. In both 1995 and 1996, normal imports of alcoholic beverages were worth about \$9 million. Normal imports of manufactured tobacco products were worth \$29 million in 1995 and \$23 million in 1996. There is also significant domestic production of cigarettes. Although there are no reliable estimates of total domestic consumption, these data suggest that leakage, at least of tobacco products, is not especially large.

Possible regulatory measures

It is being suggested that the government should introduce some form of duty drawback mechanism in order to limit loss of revenue due to leakage through re-exports. This would essentially impose normal duties on these goods and then rebate some or all of the duties when the goods are re-exported. Variations of this sort of system have been in use in a number of countries.

Given the nature of this trade, there is little doubt that such a system would virtually eliminate all activity and the revenue that it now generates. Nevertheless, this still might be a financially sensible course if there were strong indications that there were substantial imports destined for local markets that were avoiding normal duties, and that these imports would continue at much the same, or at least significant, levels when full duties were imposed. This does not seem to be the case, and it is likely that the introduction of a duty drawback system would significantly reduce revenue rather than lead to increases.

It should be kept in mind that there are few, if any, examples where duty drawback schemes are functioning in an efficient manner that is conducive to the growth and development of export industries. These systems usually look effective on paper, but in practice the process of collecting money and then returning after some action has taken place inevitably entails a lot of delays and associated costs.

The future for re-exports

Re-exports of the type described here will almost certainly decline in importance. As a member of ASEAN, Vietnam is engaged in a programme of tariff reductions as part of AFTA. Although it is taking a cautious approach to liberalisation, Vietnam will eventually open its markets sufficiently to make re-export through Cambodia much less attractive.

Other more “normal” types of re-export activity are likely to become much more important for Cambodia in the future. This will include the importation of raw materials and intermediate goods that are processed and then re-exported.

2.2. Imports

The relative importance of imported petroleum, capital equipment and industrial raw materials is clear. (Table 4.4) The 10 largest import groups for 1996 were petroleum and industrial goods, medicine, gold and tobacco and manufactures (some of which were imported tobacco used by cigarette manufacturers).

A major change between 1995 and 1996 was the sharp decrease in gold imports (SITC-97). Gold imports increased substantially in 1995 from lower levels in 1993 (\$28 million) and 1994 (\$78 million). The reduction in 1996 to \$40 million looks to be a return to a more normal level.

If these data are accurate, it might suggest a desire for people to increase the share of assets held in gold, perhaps reducing holdings of monetary assets. There were high rates of

Table 4.4. Major Imports, 1995-96 (two-digit SITC; millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
33	Petroleum and products	125.09	11.6	140.45	14.0	12
78	Road vehicles	84.92	7.9	139.48	13.9	64
65	Textile yarn, fabrics, etc	47.98	4.5	63.32	6.3	32
72	Machines for special industries	37.14	3.5	57.08	5.7	54
54	Medicinal products	39.15	3.6	49.97	5.0	28
71	Power generating equipment	29.97	2.8	43.81	4.4	46
66	Non-metal mineral manufactures	51.86	4.8	42.40	4.2	-18
97	Gold	285.62	26.6	39.73	4.0	-86
12	Tobacco and manufactures	30.36	2.8	34.18	3.4	13
67	Iron and steel	18.78	1.7	32.71	3.3	74
76	Telecom and sound equipment	24.12	2.2	29.84	3.0	24
89	Misc. manufactured goods	18.03	1.7	27.04	2.7	50
26	Textile fibres and waste	19.64	1.8	25.10	2.5	28
74	General industrial machinery	22.30	2.1	24.86	2.5	11
69	Metal manufactures	19.64	1.8	24.37	2.4	24
77	Electrical machinery	29.19	2.7	23.18	2.3	-21
64	Paper and paperboard	11.33	1.1	22.75	2.3	101
9	Misc. edible products	13.95	1.3	18.86	1.9	35
4	Cereals and preparations	33.52	3.1	16.61	1.7	-50
6	Sugar and honey	10.75	1.0	15.47	1.5	44
11	Beverages	11.41	1.1	12.37	1.2	8
79	Other transport equipment	13.33	1.2	10.47	1.0	-21
75	Office machines and equipment	5.85	0.5	9.33	0.9	60
84	Clothing and accessories	3.27	0.3	7.60	0.8	132
68	Non-ferrous metals	7.76	0.7	6.59	0.7	-15
42	Fixed vegetable oil, fat	3.36	0.3	6.51	0.7	94
3	Fish and preparations	4.64	0.4	6.46	0.6	39
55	Perfume, cleaning products	6.09	0.6	6.40	0.6	5
5	Vegetables and fruit	5.83	0.5	6.35	0.6	9
2	Dairy products, birds eggs	7.24	0.7	4.95	0.5	-32

58	Plastic materials, etc	5.11	0.5	4.60	0.5	-10
56	Fertilisers, manufactured	3.24	0.3	4.51	0.5	39
87	Precision instruments	5.78	0.5	4.45	0.4	-23
53	Dyes, tanning, colour products	0.93	0.1	4.26	0.4	359
62	Rubber manufactures	3.91	0.4	4.23	0.4	8
88	Photo and optical equipment	6.70	0.6	4.02	0.4	-40
59	Chemical materials	2.02	0.2	3.69	0.4	82
73	Metalworking machinery	2.94	0.3	3.43	0.3	17
82	Furniture and parts	7.96	0.7	2.91	0.3	-63
85	Footwear	2.12	0.2	2.58	0.3	22
81	Plumbing, heating, lighting goods	1.87	0.2	2.31	0.2	23
34	Gas, natural and manufactured	1.44	0.1	2.25	0.2	56
29	Crude animal, veg. material	1.76	0.2	2.11	0.2	20
27	Crude fertiliser, minerals	2.13	0.2	1.74	0.2	-18
52	Inorganic chemicals	0.69	0.1	0.87	0.1	25
51	Organic chemicals	0.58	0.1	0.83	0.1	42
7	Coffee, tea, cocoa, spices	0.85	0.1	0.66	0.1	-22
28	Metalliferous ores, scrap	0.03	0.0	0.62	0.1	1,960
8	Feeding stuff for animals	0.08	0.0	0.40	0.0	414
63	Wood, cork, manufactures	0.64	0.1	0.37	0.0	-42
61	Leather, dressed fur, etc	0.05	0.0	0.27	0.0	479
83	Travel goods, handbags	0.17	0.0	0.24	0.0	41
1	Meat and preparations	0.20	0.0	0.21	0.0	4
23	Rubber, crude	0.54	0.1	0.17	0.0	-69
43	Processed animal, veg. oil, etc	0.39	0.0	0.15	0.0	-61
95	Firearms, ammunition	0.23	0.0	0.13	0.0	-42
94	Zoo animals, pets, etc	0.00	0.0	0.12	0.0	1,777
57	Explosives	0.00	0.0	0.11	0.0	n.a.
0	Live animals for food	0.05	0.0	0.09	0.0	81
25	Pulp and waste paper	0.00	0.0	0.02	0.0	n.a.
22	Oil seeds	0.35	0.0	0.01	0.0	-96
24	Cork and wood	0.00	0.0	0.01	0.0	604
21	Hides, skins, furs (undressed)	0.00	0.0	0.00	0.0	123
41	Animal oils and fats	0.04	0.0	0.00	0.0	-94
35	Electrical current	0.47	0.0	0.00	0.0	-100
96	Coins, non-gold	0.04	0.0	0.00	0.0	-100
	Total	1,075.43	100.0	1,000.60	100.0	-7

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

inflation in 1992 and 1993, up to as much as 341 percent. There then followed a period of deflation, and the consumer price index decreased during early 1994. The inflation rate increased again in the fourth quarter of 1994 (26 percent) and the first quarter of 1995 (11.5 percent). Since then, the government's record on inflation has been good, averaging just over 7 percent in 1996. Although it is possible that there was an increased desire to hold gold as a reaction to earlier inflation, the lag in response makes this rationale dubious.

Since it is likely that there is strong monetary aspect to imports of gold, this transaction might more properly be a part of the capital account in the balance of payments. That is, governed more by financial factors than policies influencing trade under the current account. However, even though gold has a relatively low tariff rate of 0.3 percent, these imports have generated considerable revenue.

Specific types of major imports

Key imports can be better identified by examining the more disaggregated four-digit SITC imports. Major imports for 1996 are presented in Table 4.5. With relation to Table 4.4, road vehicles (SITC-78) actually comprised motor vehicle parts (SITC-7849), automobiles (SITC-7810), lorries and trucks (SITC-7821) and motorcycles (SITC-7851).

Table 4.5. Major Imports, 1995-96 (four-digit SITC; millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
3344	Fuel oils	121.53	11.3	139.80	14.0	15
7849	Motor vehicle parts	2.39	0.2	52.26	5.2	2,083
5413	Antibiotics in bulk	30.75	2.9	47.53	4.8	55
9710	Gold	285.62	26.6	39.73	4.0	-86
7810	Passenger motor vehicles	23.32	2.2	36.42	3.6	56
2690	Waste of textile fabrics	19.38	1.8	23.96	2.4	24
7281	Machines for special industries	4.84	0.5	23.64	2.4	389
1221	Cigars, cheroots, etc	22.47	2.1	20.49	2.1	-9
6612	Cement	16.28	1.5	19.94	2.0	23
980	Edible products	13.82	1.3	18.67	1.9	35
7821	Lorries, trucks	16.27	1.5	18.55	1.9	14
6552	Knit fabric, non-elastic	0.28	0.0	15.86	1.6	5,667
7851	Motorcycles, etc	30.39	2.8	15.72	1.6	-48
7641	Line telephones, etc	9.40	0.9	14.05	1.4	50
611	Raw beet and cane sugar	7.80	0.7	13.40	1.3	68
6536	Textile fabric	9.29	0.9	13.09	1.3	41
6911	Iron structures, parts	9.34	0.9	12.86	1.3	38
7161	DC motors and generators	17.87	1.7	12.81	1.3	-28
6534	Synthetic blend fabrics	21.04	2.0	12.52	1.3	-41
7169	Parts of electrical plants	1.52	0.1	12.04	1.2	690
	Total	663.79	62.0	563.33	56.0	

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

Major changes in imports

Areas where imports are rapidly growing or are contracting, are presented overleaf in Table 4.6. It should be kept in mind that growth rates for only two years may not constitute an ongoing trend. Furthermore, the Cambodian economy is in the midst of a fundamental transition, and trade patterns can be expected to continue to go through major changes. Nevertheless, these estimates again confirm the importance of imports for industrial activity rather than for consumption. It appears that imports are playing an increasingly necessary role for the growth in industrial investment, including investment in physical infrastructure.

The strong growth in imports of textiles reflects the input requirements of the rapidly expanding garment industry. The growth in vehicles, machinery and raw materials, such as cement, are all indicative of the requirements of an economy going through the process of industrialisation.

The decline in imports of some types of goods suggests changing economic performance (such as in the case of rice) or increasing sources of domestic supply (in the case of furniture and pottery).

2.3. Exports

Not surprisingly, the pattern of exports is much less varied than that of imports. As noted above, there are at present several key areas of export activity—timber and wood-related

Table 4.6. Expanding and Contracting Imports, 1995-96 (three-digit SITC; millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
Expanding categories of imports						
655	Knitted fabrics	0.28	0.0	15.86	1.6	5,667
784	Motor vehicle parts, accessories	3.01	0.3	52.41	5.2	1,642
46	Wheat, meal or flour	0.15	0.0	2.50	0.3	1,527
727	Food machinery, non-domestic	0.63	0.1	5.96	0.6	846
843	Womens outerwear, non-knitted	0.25	0.0	2.07	0.2	737
533	Pigments, paints, etc	0.79	0.1	4.02	0.4	409
692	Metal tanks, boxes, etc	0.76	0.1	3.74	0.4	391
711	Steam boilers	2.58	0.2	7.82	0.8	202
728	Machines for special industries	10.29	1.0	30.80	3.1	199
759	Office machines, parts	2.28	0.2	5.93	0.6	161
663	Mineral manufactures	0.78	0.1	2.01	0.2	157
652	Cotton fabrics, woven	2.59	0.2	6.61	0.7	155
792	Aircraft	1.93	0.2	4.85	0.5	152
424	Fixed vegetable oil, non-soft	2.53	0.2	6.32	0.6	150
651	Textile yarn	0.75	0.1	1.86	0.2	149
771	Electrical power machinery	0.83	0.1	1.99	0.2	141
741	Heating, cooling equipment	3.08	0.3	7.31	0.7	137
673	Iron, steel shapes, etc	6.77	0.6	15.58	1.6	130
783	Road motor vehicles	2.55	0.2	5.84	0.6	129
641	Paper and paperboard	7.26	0.7	16.65	1.7	129
899	Other manufactured goods	5.42	0.5	11.65	1.2	115
674	Iron, steel, plate and sheet	2.52	0.2	5.22	0.5	107
677	Iron, steel wire	4.02	0.4	7.87	0.8	96
	Total	62.02	5.8	224.84	22.5	
Contracting categories of imports						
24	Cheese and curd	1.86	0.2	0.03	0.0	-98
656	Lace, ribbons, etc	7.24	0.7	0.55	0.1	-92
791	Railway vehicles	2.41	0.2	0.29	0.0	-88
971	Gold	285.62	26.6	39.73	4.0	-86
335	Residual petroleum products	3.56	0.3	0.65	0.1	-82
665	Glassware	3.94	0.4	0.91	0.1	-77
885	Watches and clocks	4.39	0.4	1.12	0.1	-75
666	Pottery	6.33	0.6	1.92	0.2	-70
42	Rice	24.35	2.3	7.91	0.8	-68
737	Metalworking machinery	1.13	0.1	0.40	0.0	-65
821	Furniture, parts	7.96	0.7	2.91	0.3	-64
762	Radio broadcast receivers	1.58	0.2	0.59	0.1	-63
58	Fruit, preserved, prepared	2.64	0.3	1.11	0.1	-58
41	Wheat, unmilled	6.01	0.6	2.55	0.3	-58
699	Base metal manufactures	4.18	0.4	2.01	0.2	-52
721	Agricultural machinery	1.36	0.1	0.72	0.1	-47
778	Electrical machinery	19.86	1.9	10.55	1.1	-47
785	Cycles, motorised or not	33.48	3.1	18.90	1.9	-44
273	Stone, sand and gravel	1.17	0.0	0.67	0.1	-42
743	Pumps, centrifuges, etc	6.45	0.6	3.74	0.4	-42
723	Civil engineering equipment	12.17	1.1	7.11	0.7	-42

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

goods, garments and rubber. There were also large recorded exports under Harmonised System classification 49.07.00 (SITC-8928)—printed matter. In 1995, these exports amounted to approximately \$219 million, and in 1996 to \$146 million.

Table 4.7. Major Exports, 1995-96 (two-digit SITC; millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
89	Misc. manufactured goods	220.05	58.8	170.57	44.6	-22
84	Clothing and accessories	24.25	6.5	77.24	20.2	219
24	Cork and wood	63.88	17.1	37.17	9.7	-42
23	Rubber, crude	31.43	8.4	31.95	8.3	2
96	Coins, non-gold	0.00	0.0	21.91	5.7	n.a.
63	Wood, cork, manufactures	7.39	2.0	14.34	3.7	94
12	Tobacco and manufactures	2.69	0.7	4.24	1.1	57
26	Textile fibres and waste	0.35	0.1	3.00	0.8	754
3	Fish and preparations	5.00	1.3	2.96	0.8	-41
65	Textile yarn, fabrics	2.21	0.6	2.75	0.7	25
4	Cereals and preparations	1.59	0.4	2.32	0.6	46
11	Beverages	0.72	0.2	2.29	0.6	217
79	Transport equipment	4.75	1.3	1.61	0.4	-66
29	Crude animal, veg. materials	1.00	0.3	1.57	0.4	58
22	Oil seeds	0.32	0.1	1.20	0.3	270
72	Machines for special industries	0.02	0.0	1.18	0.3	5,803
71	Power generating equipment	0.20	0.1	0.91	0.2	358
78	Road vehicles	0.58	0.2	0.79	0.2	36
64	Paper and paperboard	0.14	0.0	0.62	0.2	339
76	Telecom and sound equipment	0.24	0.1	0.61	0.2	153
73	Metalworking machinery	0.00	0.0	0.54	0.1	n.a.
77	Electrical machinery	0.08	0.0	0.47	0.1	515
85	Footwear	0.03	0.0	0.31	0.1	917
28	Metalliferous ores, scrap	0.12	0.0	0.31	0.1	153
88	Photo and optical equipment	0.44	0.1	0.28	0.1	-36
69	Metal manufactures	0.20	0.1	0.23	0.1	13
5	Vegetables and fruit	0.35	0.1	0.20	0.1	-43
82	Furniture, parts	0.10	0.0	0.17	0.0	58
55	Perfume, cleaning products	0.11	0.0	0.15	0.0	38
61	Leather, dressed fur, etc	0.00	0.0	0.14	0.0	n.a.
74	General industrial machinery	0.01	0.0	0.14	0.0	182
87	Precision instruments	0.10	0.0	0.11	0.0	8
66	Non-metal mineral manufactures	0.02	0.0	0.11	0.0	520
0	Live animals for food	0.00	0.0	0.06	0.0	n.a.
33	Petroleum and products	0.00	0.0	0.05	0.0	13,677
8	Feeding stuff for animals	0.06	0.0	0.05	0.0	-12
21	Hides, skins, furs (undressed)	0.21	0.1	0.05	0.0	-79
1	Meat and preparations	0.00	0.0	0.04	0.0	n.a.
75	Office machines and equipment	0.16	0.0	0.04	0.0	-73
52	Inorganic chemicals	0.00	0.0	0.02	0.0	n.a.
67	Iron and steel	0.00	0.0	0.01	0.0	n.a.
68	Non-ferrous metals	0.00	0.0	0.01	0.0	4,323
53	Dyes, tanning, colour products	0.06	0.0	0.01	0.0	-84
81	Plumbing, heating and lighting	0.04	0.0	0.01	0.0	-76
54	Medicinal products	0.41	0.1	0.01	0.0	-98
34	Gas, natural and manufactured	0.00	0.0	0.01	0.0	n.a.
7	Coffee, tea, cocoa, spices	0.02	0.0	0.01	0.0	-65
43	Processed animal, veg. oil, etc	0.00	0.0	0.01	0.0	n.a.
62	Rubber manufactures	2.72	0.7	0.00	0.0	-100
58	Plastic materials	0.00	0.0	0.00	0.0	n.a.
2	Dairy products, birds eggs	0.00	0.0	0.00	0.0	-46

59	Chemical materials	0.00	0.0	0.00	0.0	-80
9	Misc. edible products	0.00	0.0	0.00	0.0	n.a.
27	Crude fertiliser, minerals	0.00	0.0	0.00	0.0	-88
6	Sugar and honey	0.00	0.0	0.00	0.0	-100
83	Travel goods, handbags	2.40	0.6	0.00	0.0	-100
97	Gold	0.00	0.0	0.00	0.0	-100
	Total	374.51	100.0	382.77	100.0	2

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

Table 4.7 reflects the statistical importance of SITC-89. When it is taken into account, total exports reflected in the recorded customs data increased by 2.2 percent between 1995 and 1996. However, when SITC-89 is excluded, recorded exports declined by 29 percent. (World Bank reports reflect a decrease in total exports of 18.5 percent, but an increase in “domestic exports” of 10.8 percent.)

Table 4.7 provides an indication of the extent of the growth of the garment industry (SITC-84). Exports increased from \$24.2 million to \$77.2 million, an almost 220-percent increase in a single year. (It appeared that comparable growth in the industry continued into the first half of 1997.)

Recorded exports of cork and wood (SITC-24) declined by 42 percent, but were still significant—falling from \$63.9 million to \$37.2 million. However, exports of wood and cork manufactured products (SITC-63) increased substantially, by about \$7 million (94 percent).

In contrast, exports of rubber (SITC-23) remained virtually unchanged: \$31.4 million in 1995, increasing by 2 percent to \$31.9 million in 1996.

If SITC-89 is excluded, these export activities accounted in 1996 for 76 percent of total exports. They constituted about 41 percent when SITC-89 is included.

The remainder of Table 4.7 suggests that there is a wide range of other goods that were being exported. Some of these goods are not manufactured in Cambodia and are most likely re-exports of some form. However, there are some activities that might form the basis for future diversification of the export base. In particular, there are recorded exports for a number of food- or agriculture-related goods, such as fish, tobacco, cereal, etc.

A more detailed picture of export activity can be gained from estimates of goods at the four-digit SITC level of aggregation. Table 4.8 indicates more specific export products. These include many of the types of garment, rubber and wood products suggested by the more aggregate estimates. In addition, a number of food products are also reflected, including palm, rice, wine and tobacco products.

2.4. Re-Exports

We now turn to an area that is handled somewhat differently in Cambodia than in other countries—the re-export trade. In most places, re-exports enter and leave with little or no transformation and are typically permitted to come and go duty free. It is not unusual for duty rebate or drawback systems to be in place to ensure that the goods are in fact re-exported. (These types of systems are also sometimes used in an attempt to compensate exporters for duties paid on imported raw materials and intermediate goods.)

Re-exports are of particular concern in Cambodia because they are admitted at concessionary duty rates and it is recognised that their eventual export is informal. It is important to note that goods are identified as re-export goods on admittance, and that there is no official or documentary evidence of their departure. Customs data suggest that Vietnam is the only destination for goods entering Cambodia as re-exports.

Recent levels of re-exports are significant. Tables 4.7 and 4.8 show that if SITC-89 is included with exports, then re-export totals amount to roughly two-thirds of export totals. For

Table 4.8. Major Exports, 1995-96 (four-digit SITC; millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
8451	Jerseys, pullovers, etc	14.26	3.8	33.21	8.7	133
2331	Synthetic rubber	26.87	7.2	31.01	8.1	15
8960	Works of art	0.04	0.0	24.47	6.4	n.a.
9610	Coins, non-gold	0.00	0.0	21.91	5.7	n.a.
8459	Other clothing accessories	3.21	0.9	16.21	4.2	404
8462	Other cotton, non-elastic	4.61	1.2	15.61	4.1	239
6341	Veneer sheets	2.53	0.7	8.23	2.2	226
8439	Other outer garments	0.99	0.3	5.92	1.6	501
6342	Plywood or wood sheets	4.45	1.2	5.88	1.5	32
8435	Blouses	0.43	0.1	4.21	1.1	872
1221	Cigars, cheroots, etc	2.48	0.7	3.38	0.9	36
2690	Waste of textile fabrics	0.30	0.1	2.99	0.8	899
1121	Wine	0.19	0.1	1.97	0.5	929
2923	Vegetable materials	0.92	0.2	1.37	0.4	50
2232	Palm nuts and kernels	0.14	0.0	1.09	0.3	667
6536	Textile fabrics	0.26	0.1	0.96	0.3	276
421	Rice (in husk or husked)	0.00	0.0	0.95	0.3	n.a.
8463	Other synthetic fibres, non-elastic	0.11	0.0	0.91	0.2	704
7929	Aircraft parts	0.01	0.0	0.90	0.2	7,749
7234	Construction, mining machinery	0.00	0.0	0.89	0.2	n.a.
7131	Aircraft engines, parts	0.00	0.0	0.78	0.2	n.a.
459	Other cereals (unmilled)	0.59	0.2	0.73	0.2	24
1211	Tobacco, (unstripped)	0.21	0.1	0.62	0.2	192
7928	Aircraft, associated equipment	0	0	0.6	0.2	n.a.
2332	Reclaimed scrap rubber	0.26	0.1	0.59	0.2	122
7373	Welding machines	0	0	0.54	0.1	n.a.
	Total	62.87	16.8	185.92	48.6	n.a.

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

certain types of goods, the amounts entering as re-exports far exceed imports officially destined for the domestic market (e.g. beverages and tobacco).

Table 4.9 provides an indication of the general structure of the re-export trade. Cigarettes are by far the largest type of re-exported good.

Table 4.9. Major Re-Exports, 1995-96 (two-digit SITC; millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
12	Tobacco and manufactures	188.65	75.1	189.18	82.1	0
76	Telecom and sound equipment	37.77	15.0	17.49	7.6	-54
11	Beverages	16.49	6.6	16.23	7.0	-2
78	Road vehicles	8.06	3.2	7.26	3.2	-10
52	Inorganic chemicals	0.00	0.0	0.07	0.0	n.a.
51	Organic chemicals	0.01	0.0	0.05	0.0	390
74	General industrial machinery	0.01	0.0	0.02	0.0	370
8	Feed for animals	0.01	0.0	0.02	0.0	132
5	Vegetables and fruit	0.00	0.0	0.00	0.0	n.a.
72	Machines for special industries	0.24	0.1	0.00	0.0	-100
27	Crude fertiliser, minerals	0.02	0.0	0.00	0.0	-100
89	Misc. manufactured goods	0.00	0.0	0.00	0.0	-100
	Total	251.25	100.0	230.31	100.0	-8

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

It is interesting that some unusual products are recorded as re-exports, albeit in relatively small amounts. For example, fertiliser and chemicals would not seem to be normal candidates for informal cross-border trade (it may be that they were treated as re-exports by mistake).

Table 4.10. Major Re-Exports, 1995-96 (four-digit SITC; millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)	Growth (%)
1221	Cigars, cheroots, etc	187.91	74.8	187.20	81.3	0
7611	Colour television receivers	20.07	8.0	10.40	4.5	-48
7851	Motorcycles	7.51	3.0	7.26	3.2	-3
1123	Beer, ale, stout, porter	7.64	3.0	6.01	2.6	-21
1121	Wine	2.62	1.0	4.87	2.1	86
7638	Sound apparatus	11.88	4.7	4.76	2.1	-60
1124	Distilled alcoholic beverages	5.45	2.2	4.21	1.8	-23
7622	Portable radio receivers	3.73	1.5	1.68	0.7	-55
1110	Non-alcoholic beverages	0.67	0.3	1.34	0.5	68
1223	Manufactured tobacco	0.74	0.3	1.12	0.5	51
1211	Tobacco (unstripped)	0.00	0.0	0.86	0.4	n.a.
7643	Television, radio transmitters	1.95	0.8	0.48	0.2	-76
7628	Other radio receivers	0.00	0.0	0.16	0.1	n.a.
5222	Inorganic acids	0.00	0.0	0.07	0.0	n.a.
5121	Acrylic alcohols, derivatives	0.01	0.0	0.05	0.0	390
7442	Lifting, loading machines	0.01	0.0	0.02	0.0	300
811	Hay, fodder (green, dry)	0.01	0.0	0.02	0.0	132
7649	Equipment parts of SITC-76	0.03	0.0	0.01	0.0	-75
7631	Electrical gramophones	0.07	0.0	0.01	0.0	-90
589	Fruit (prepared, preserved)	0.00	0.0	0.00	0.0	n.a.
7415	Air-conditioning machinery	0.00	0.0	0.00	0.0	n.a.
7831	Buses	0.45	0.2	0.00	0.0	-100
7259	Parts of SITC-725	0.22	0.1	0.00	0.0	-100
1122	Cider, perry, mead, etc	0.10	0.0	0.00	0.0	-100
7810	Passenger motor vehicles	0.08	0.0	0.00	0.0	-100
7648	Telecom equipment	0.05	0.0	0.00	0.0	-100
7853	Invalid carriers, parts	0.02	0.0	0.00	0.0	-100
2789	Minerals (crude)	0.02	0.0	0.00	0.0	-100
7224	Wheeled tractors	0.02	0.0	0.00	0.0	-100
7272	Food processing machinery	0.01	0.0	0.00	0.0	-100
8939	Misc. plastic articles	0.00	0.0	0.00	0.0	-100
	Total	251.25	100.0	100.00	100.0	-8

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

2.5 Direction of Trade

Imports

Identifying the sources of imports and the destination of exports is useful in getting a sense of the potential for expanding trade and exploiting commercial opportunities. The direction of trade will be increasingly important as Cambodia joins ASEAN and is integrated into AFTA. For example, future sources of imports will have an impact on trade tax revenues.

The data collected by the Customs Department include codes for partner countries and these have been used to assess the direction of recent trade. Estimates of imports for major trading partners are presented in Table 4.11.

The dominance of Singapore as a reported source of imports is clear, with nearly one-half of imports for both 1995 and 1996, though it is likely that a substantial share of the large amount of imports coming through Singapore is actually being transhipped from other countries. To get some idea of the potential extent of this, consider the broad distribution of imports from Singapore (Table 4.12). It is likely that substantial amounts of many of these imports actually originate elsewhere, such as transport equipment. There may also be substantial transshipment of imports through Thailand. However, given Thailand's relatively greater production capacity of many of the imports received, the case here is less firm.

Table 4.11. Source of Imports - Major Trading Partners (millions of dollars)

Country	1995	Share (%)	1996	Share (%)	Growth (%)
Singapore	529.73	49.3	457.69	45.7	-14
Thailand	133.73	12.4	137.01	13.7	3
Vietnam	109.09	10.1	119.63	12.0	10
Taiwan	9.19	0.9	42.92	4.3	367
Japan	64.11	6.0	32.62	3.3	-49
China	28.40	2.6	28.41	2.8	0
Hong Kong	58.18	5.4	23.83	2.4	-60
Malaysia	15.46	1.4	19.71	2.0	28
France	34.44	3.2	18.83	1.9	-45
United States	17.41	1.6	15.49	1.5	-11
Italy	0.44	0.0	14.84	1.5	3,569
Indonesia	9.09	0.8	9.31	0.9	2
Australia	13.60	1.3	5.21	0.5	-62
Germany	7.75	0.7	2.58	0.3	-67
Denmark	0.18	0.0	1.87	0.2	953
Spain	0.23	0.0	1.41	0.1	504
Belgium	0.42	0.0	1.31	0.1	208
United Kingdom	0.81	0.1	1.10	0.1	36
India	0.96	0.1	0.83	0.1	-13
Russian Federation	1.64	0.1	0.69	0.1	-58
Austria	0.16	0.2	0.37	0.0	131
Netherlands	0.23	0	0.33	0.0	43
Philippines	1.70	0	0.32	0.0	-82
New Zealand	0.25	0.2	0.14	0.0	-45
Laos	0.00	0.0	0.05	0.0	7932
Myanmar	0.00	0.0	0.01	0.0	n.a.
Ireland	0.10	0.0	0.00	0.0	-98
Portugal	0.03	0.0	0.00	0.0	-100
Greece	0.00	0.0	0.00	0.0	n.a.
Sub-Total	1,037.30	96.5	936.54	93.6	-10
Total	1,075.43	100.0	1,000.60	100.0	-7

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

Table 4.12. Imports from Singapore, 1995-96 (one-digit SITC; millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)
0	Food and live animals	20.07	3.8	23.00	5.0
1	Beverages and tobacco	21.57	4.1	30.62	6.7
2	Crude materials (excluding fuels)	19.16	3.6	23.28	5.1
3	Mineral fuels	22.23	4.2	21.44	4.7
4	Animal, vegetable oil, fat	3.54	0.7	6.17	1.3
5	Chemicals, related products	19.96	3.8	44.22	9.7
6	Basic manufactures	66.00	12.6	91.12	19.9
7	Machines, transport equipment	133.69	25.2	159.30	34.8
8	Misc. manufactured goods	16.94	3.2	20.65	4.5
9	Goods not classd by kind	205.98	38.9	37.89	8.3
	Total	529.73	100.0	100.00	100.0

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

After Singapore, Thailand and Vietnam—Cambodia's largest neighbours—are the largest sources of imports. (Laos accounted for only a small amount of imports, though informal border trade may have been greater. We have no way on knowing much about border trade, not least because there are still security concerns in many border areas.) Along with Singapore, Thailand and Vietnam accounted for about 70 percent of recorded imports in both 1995 and 1996. Beyond this, there are a large number of identified sources of imports.

It is interesting to note that Taiwan and several EU countries substantially increased their imports to Cambodia in 1996. Imports from Taiwan increased to nearly \$43 million. Imports from Italy, Denmark, Spain and Belgium all recorded significant proportional growth. Italy's imports amounted to nearly \$15 million in 1996.

There were large decreases in imports from Japan (from about \$64 million to \$33 million), Hong Kong (from \$58 million to \$24 million) and France (from \$34 million to almost \$19 million). However, it should be kept in mind that overall there was a 7 percent decline in total imports between 1995 and 1996.

There is considerable interest in the pattern of trade with major trade blocs. This arises in part as a result of Cambodia's impending membership in ASEAN, but also reflects the need for the Cambodian government to maintain trade relations with groups such as the EU. Estimates of sources of imports are re-arranged in Table 4.13 to reflect major trade blocs—ASEAN, other Asia-Pacific Economic Cooperation (APEC) or Pacific Rim countries, the EU, and others.

As indicated above, ASEAN is by far the largest recorded source of imports, amounting to a little more than 74 percent in both 1995 and 1996.

The next most important trading bloc is the less formal "other" APEC countries (APEC countries other than ASEAN members), which includes Taiwan, Japan, China, Hong Kong, the United States, Australia and New Zealand. These countries accounted for almost 18 percent of imports in 1995, falling to 15 percent in 1996. However, if there are in fact a large amount of imports being transhipped through Singapore, it is likely that this trade is to a large extent at the expense of these countries. The decline in the share of imports from other APEC countries is largely a reflection of the decline in imports from Japan and Hong Kong.

The share of imports from the EU was stable and relatively small, at around 4 percent.

Table 4.13. Source of Imports - Major Trading Blocs, 1995-96 (millions of dollars)

Trading Bloc	1995	Share (%)	1996	Share (%)	Growth (%)
ASEAN					
Singapore	529.73	49.3	457.69	45.7	-14
Thailand	133.73	12.4	137.01	13.7	3
Vietnam	109.09	10.1	119.63	12.0	10
Malaysia	15.46	1.4	19.71	2.0	28
Indonesia	9.09	0.8	9.31	0.9	2
Philippines	1.70	0.2	0.32	0.0	-82
Laos	0.00	0.0	0.05	0.0	7,932
Myanmar	0.00	0.0	0.01	0.0	n.a.
Total	798.80	74.3	743.73	74.3	-7
Other APEC					
Taiwan	9.19	0.9	42.92	4.3	367
Japan	64.11	6.0	32.62	3.3	-49
China	28.40	2.6	28.41	2.8	0
Hong Kong	58.18	5.4	23.83	2.4	-59
United States	17.41	1.6	15.49	1.5	-11
Australia	13.60	1.3	5.21	0.5	-62
New Zealand	0.25	0.0	0.13	0.0	-45
Total	191.13	17.8	148.63	14.9	-22
European Union					
France	34.44	3.2	18.83	1.9	-45
Italy	0.40	0.0	14.84	1.5	3,569
Germany	7.75	0.7	2.58	0.3	-67
Denmark	0.18	0.0	1.87	0.2	953
Spain	0.23	0.0	1.41	0.1	504

Belgium	0.42	0.0	1.31	0.1	208
United Kingdom	0.81	0.1	1.10	0.1	36
Austria	0.16	0.0	0.37	0.0	131
Netherlands	0.23	0.0	0.33	0.0	43
Ireland	0.10	0.0	0.02	0.0	-98
Portugal	0.03	0.0	0.00	0.0	-100
Greece	0.00	0.0	0.00	0.0	n.a.
Total	44.77	4.2	42.66	4.3	-5
Other					
India	0.96	0.1	0.83	0.1	-13
Russian Federation	1.64	0.2	0.69	0.1	-58
Total	2.60	0.2	1.52	0.2	-41
Sub-Total	1,037.30	96.5	936.54	93.6	-10
Total	1,075.43	100.0	1,000.60	100.0	-7

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

Exports

There is a similar picture with regard to the reported destinations of exports (see Table 4.14). Thailand and Singapore, their relative positions reversed, are the dominant export destina-

Table 4.14. Destination of Exports - Major Trading Partners (millions of dollars)

Country	1995	Share (%)	1996	Share (%)	Growth (%)
Thailand	173.48	46.3	116.83	30.5	-33
Singapore	107.27	28.6	109.17	28.5	2
France	8.91	2.4	39.61	10.3	344
United Kingdom	9.43	2.5	30.57	8.0	224
Vietnam	13.67	3.7	24.43	6.4	79
Germany	3.43	0.9	12.93	3.4	277
Hong Kong	21.20	5.7	11.51	3.0	-46
Taiwan	7.85	2.1	7.60	2.0	-3
China	3.55	0.9	5.53	1.4	56
Japan	5.29	1.4	5.04	1.3	-5
Malaysia	2.16	0.6	3.13	0.8	45
Netherlands	0.87	0.2	2.29	0.6	162
Belgium	1.16	0.3	2.20	0.6	90
United States	4.38	1.2	2.07	0.5	-53
Denmark	0.74	0.2	1.75	0.5	137
Ireland	0.00	0.0	1.65	0.4	n.a.
Russian Federation	0.11	0.0	0.92	0.2	741
Australia	0.31	0.1	0.62	0.2	100
Portugal	0.00	0.0	0.58	0.2	n.a.
Indonesia	2.76	0.7	0.53	0.1	-81
Spain	0.00	0.0	0.29	0.1	n.a.
Italy	0.02	0	0.16	0.0	654
Austria	0.00	0	0.15	0.0	n.a.
Philippines	0.76	0.2	0.13	0.0	-83
Myanmar	0.00	0.0	0.08	0.0	n.a.
Laos	0.72	0.2	0.05	0.0	-92
Greece	0.00	0.0	0.05	0.0	n.a.
New Zealand	0.00	0.0	0.01	0.0	n.a.
India	0.39	0.1	0.00	0.0	-100
Sub-Total	368.45	98.4	379.87	99.2	3
Total	374.51	100.0	382.77	100.0	2

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

tions. As a result, the Customs Department data faces much the same problem regarding transshipments and the interpretation of the ultimate destination of exports.

In an attempt to gain insight into the potential transshipment of Cambodia's exports through Thailand, consider the general composition of exports to Thailand (Table 4.15). From this, it is clear that this trade falls into three broad categories:

- Crude materials, which include rubber as well as some of the other types of agriculture-based exports noted above;
- Manufactured goods, primarily garments; and
- Goods not classified, which includes gold.

Although it is certainly possible that some of these goods are being sold in Thai markets and/or being used as inputs to production, it is likely that substantial amounts are being re-exported. The same applies to exports to Singapore. As a result, we should be cautious in identifying Cambodia's export markets.

Table 4.15. Exports to Thailand, 1995-96 (one-digit SITC; millions of dollars)

SITC	Sector	1995	Share (%)	1996	Share (%)
0	Food and live animals	0.45	0.3	0.27	0.2
1	Beverages and tobacco	0.00	0.0	0.44	0.4
2	Crude materials (excluding fuels)	32.04	18.5	13.96	12.0
3	Mineral fuels	0.00	0.0	0.00	0.0
4	Animal, vegetable oil, fat	0.00	0.0	0.01	0.0
5	Chemicals, related products	0.11	0.1	0.00	0.0
6	Basic manufactures	0.35	0.2	0.72	0.6
7	Machines, transport equipment	0.12	0.1	0.23	0.2
8	Misc. manufactured goods	140.41	80.9	80.92	69.3
9	Goods not classd by kind	0	0.0	20.29	17.4
	Total	173.48	100.0	116.83	100.0

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

Perhaps the most noteworthy aspect of these estimates is the sharp increase in exports destined for the EU, up \$67.6 million from \$24.6 million to \$92.2 million over one year. This amounted to an increase in the share of exports from 6.6 percent to 24.1 percent. This was largely driven by the expansion of exports of garments.

The increase in the export share to the EU came at the expense of both ASEAN and the other APEC countries. However, there is a good chance that some part of this growth in fact reflected a shift in the means of transporting garments to the EU. Exports to Thailand of SITC-8 (mainly garments) fell by nearly \$60 million between 1995 and 1996. (At the same time, exports to Singapore of goods falling under SITC-8 increased by about \$7 million.)

Table 4.16. Destination of Exports - Major Trading Blocs, 1995-96 (millions of dollars)

Trading Bloc	1995	Share (%)	1996	Share (%)	Growth (%)
ASEAN					
Thailand	173.48	46.3	116.83	30.5	-33
Singapore	107.27	28.6	109.17	28.5	2
Vietnam	13.67	3.7	24.43	6.4	79
Malaysia	2.16	0.6	3.13	0.8	45
Indonesia	2.76	0.7	0.53	0.1	-81
Philippines	0.76	0.2	0.13	0.0	-83
Myanmar	0.00	0.0	0.08	0.0	n.a.
Laos	0.72	0.2	0.05	0.0	-92
Total	300.81	80.3	254.35	66.5	-18
Other APEC					
Hong Kong	21.20	5.7	11.51	3.0	-46
Taiwan	7.85	2.1	7.60	2.0	-3

China	3.55	0.9	5.53	1.4	56
Japan	5.29	1.4	5.04	1.3	-5
United States	4.38	1.2	2.07	0.5	-53
Australia	0.31	0.1	0.62	0.2	100
New Zealand	0.00	0.0	0.01	0.0	n.a.
Total	42.57	11.4	32.37	8.5	-32
European Union					
France	8.91	2.4	39.61	10.3	344
United Kingdom	9.43	2.5	30.57	8.0	224
Germany	3.43	0.9	12.93	3.4	277
Netherlands	0.87	0.2	2.29	0.6	162
Belgium	1.16	0.3	2.20	0.6	90
Denmark	0.74	0.2	1.75	0.5	137
Ireland	0.00	0.0	1.65	0.4	n.a.
Portugal	0.00	0.0	0.58	0.2	n.a.
Spain	0.00	0.0	0.29	0.1	n.a.
Italy	0.02	0.0	0.16	0.0	654
Austria	0.00	0.0	0.15	0.0	n.a.
Greece	0.00	0.0	0.05	0.0	n.a.
Total	24.57	6.6	92.22	24.1	73
Other					
Russian Federation	0.11	0.0	0.92	0.2	741
India	0.39	0.1	0.00	0.0	-100
Total	0.50	0.1	0.92	0.2	46
Sub-Total	368.45	98.4	379.87	99.2	3
Total	374.51	100.0	382.77	100.0	2

Source: Customs Department data; these estimates have been developed by the project team and should be seen as provisional

Re-Exports

There is little to be said with regard to direction of the re-export trade, other than, as reflected in the Customs Department data, it goes exclusively to Vietnam. The sources of the goods being imported and then re-exported cannot be drawn from the available data.

3. Trade Policy Issues Arising with AFTA/CEPT

3.1. The Present Situation

Throughout this paper, the focus has been on steps that would improve the foundation for growth and development in the trade and industry sectors. One of the most important steps would be effective integration into ASEAN and AFTA. This may well be the most significant factor influencing trade and industry for the next 10 to 20 years.

An active role in ASEAN could transform Cambodia into an important platform for investment—both for products aimed at the ASEAN market and in association with other ASEAN producers exporting to the rest of the world. This might be the most significant economic benefit to Cambodia from ASEAN membership.

However, Cambodia's membership in ASEAN is still uncertain in the wake of the fighting in July 1997. Eventual membership seems likely, but views are divided as to whether this is more likely to take place in late 1997 or mid-1998, or possibly later.

There are several important issues facing the government concerning trade policies and the strategy for the implementation of the CEPT scheme. These centre around how rapidly

and comprehensively tariffs for AFTA trade will be reduced towards an agreed target of 0 to 5 percent. However, it is also necessary to take into account the shorter term revenue impacts of alternative CEPT proposals. The government relies heavily on tariff revenues, and any moves that would adversely affect revenues must be carefully considered.

Although the schedule for ASEAN membership is now uncertain, it makes good sense for the government to be fully prepared for AFTA membership whenever it arrives. This means that its strategy and proposals for CEPT provisions should be designed, agreed upon and ready for implementation.

3.2. The Revenue Question

Perhaps the most daunting issue in the minds of many senior government officials is the possible loss of revenue resulting from the reduction of tariffs. However, there is, we believe, a way in which a large share of revenues could be effectively protected in this process.

First, it needs to be recognised that a large share of total tariff revenues is derived from a relatively small number of goods. Based on average revenues from all taxes on imports for 1995 and 1996, 23 tariff lines alone (at the six-digit Harmonised System) yielded an average 76.4 percent of total revenue. When similar Harmonised System classifications are combined, this accounts for 16 goods (Table 4.17). However, it is apparent that the tax base is even narrower than this suggests, with nearly 71 percent of all revenues from imports being derived from five goods.

An additional 7.5 percent of total revenue is derived from the next 34 tariff lines. The remaining 15.7 percent of revenue is spread over a remaining 1,734 tariff lines.

Table 4.17. Revenue Shares for Major Goods, 1995-96 (four-digit HS; average percentages)

HS	Good	Total	Singapore	ASEAN-4	World
2710	Petroleum	41.9	58.3	3.2	38.5
2402	Cigarettes	15.7	82.6	5.9	11.5
2203	Beer	4.6	97.4	0.8	1.9
8703	Automobiles	4.3	53.1	2.6	44.3
8711	Motorcycles	4.1	76.4	4.0	19.7
6309	Used clothing	1.0	87.8	0.1	12.1
2523	Cement	0.7	0.3	83.9	15.8
2208	Alcohol	0.6	73.2	6.2	20.5
8528	Electronics	0.5	93.2	0.6	6.2
2103	Food (condiments)	0.5	56.6	27.0	16.4
1701	Cane sugar	0.5	5.2	94.7	0.1
5515	Woven fabrics	0.5	65.1	11.4	23.6
8503	Electronic components	0.5	5.6	0.2	94.1
3004	Medicines	0.5	67.1	13.2	19.7
8704	Trucks and components	0.4	28.4	20.8	50.8
8465	Machine tools	0.4	1.7	0.2	98.1
	Total	76.8	65.4	5.3	29.3

Source: Customs Department data; these estimates have been developed by the project team using an average of 1995 and 1996 import values (which exclude revenue from re-exports), and should be considered as provisional; ASEAN-4 refers to ASEAN members other than Singapore (Thailand, the Philippines, Malaysia and Indonesia); World refers to the rest of the world

Table 4.17 indicates whether each of these revenue components was levied on trade with Singapore, the other original ASEAN member states (Indonesia, Malaysia, the Philippines and Thailand) or the rest of the world. There are several points worth raising here:

- 76.8 percent of total revenue amounts to \$173.5 million, and this was levied on total imports in this group of about \$331.8 million, roughly one-third of average total imports. The average effective tax rate for this group was about 52 percent.

- Nearly two-thirds of these revenues were from taxes levied on trade from Singapore. Only 5.3 percent of these revenues were from imports with the ASEAN-4. (Most of this is accounted for by imports of cement, largely from Thailand, and sugar.)
- The large levels and pattern of goods imported from Singapore raises once again the question as to how much of this trade originated elsewhere and has only been transshipped through Singapore.

Shifting the burden from tariffs to excise taxes

Only six of the 16 major revenue goods have tariff rates of 35 or 50 percent (Table 4.18). An equal number have tariff rates of 7 percent.

Estimates of the effective trade tax rates (ETRs—total trade tax revenues divided by the value of imports) give an indication of the extent to which additional taxes apply to imports of some of these types of goods. The right-hand column in Table 4.18 reflects the difference between the estimated ETR and the observed tariff rates. We know that in some cases some imports are exempted from duty. Since these are average measures, the greater the extent of exemptions, the more the differences between ETRs and tariff rates will understate the rates of other taxes (the marginal rates of tax).

One reason for examining these estimates is to make clear that for several of the most important sources of revenue, other excise taxes are already in place and are responsible for significant revenue. However, many of the other imports in Table 4.18 evidently are not subject to tax beyond the tariff and the 4 percent consumption tax.

This extends beyond the specific concerns associated with the implementation of the CEPT scheme. It is important for economic policy to distinguish clearly between tariffs, which are levied only on imports, and other taxes that are levied equally on both imports and domestically produced goods.

Applying only tariffs to imported goods can constitute a high incentive encouraging investors to move resources into these industries. It is unlikely that the government intends to provide high rates of protection for activities such as the manufacture of cigarettes, beer and soft drinks. However, that would appear to have been the unintended result. (The apparent growth of production in these areas suggests that the incentives may indeed have had an impact on shifting investment.)

Table 4.18. Effective Trade Tax and Tariff Rates for Major Revenue Goods (percentages)

HS	Good	ETR	Tariff	Difference
2710	Petroleum	77.8	20.0	57.8
2402	Cigarettes	165.0	50.0	115.0
2203	Beer	160.4	50.0	110.4
8703	Automobiles	40.5	50.0	-9.5
8711	Motorcycles	41.3	35.0	6.3
6309	Used clothing	10.0	7.0	3.0
2523	Cement	8.7	7.0	1.7
2208	Alcohol	67.2	50.0	17.2
8528	Electronics	40.5	35.0	5.5
2103	Food (condiments)	11.0	7.0	4.0
1701	Cane sugar	10.9	7.0	3.9
5515	Woven fabrics	7.5	7.0	0.5
8503	Electronic components	16.3	15.0	1.3
3004	Medicines	3.7	7.0	-3.3
8704	Trucks and components	14.0	15.0	-1.0
8465	Machine tools	9.0	15.0	-6.0

Source: Customs Department data; these estimates have been developed by the project team using an average of 1995 and 1996 import values (which exclude revenue from re-exports), and should be considered as provisional

There is no reason why the government could not integrate most of these and other goods into the CEPT tariff reduction and make a corresponding adjustment in the excise tax rates so as to maintain similar levels of revenues. This would lead to significant improvements in the climate for investment and offer the best prospects for maximising real economic growth.

Higher revenues with greater imports

There is another dimension to the revenue question that should be kept in mind—the additional revenues that would be derived from increased levels of imports. There are at least two reasons why imports are likely to increase with the introduction of lower CEPT tariff rates. The first is that the more open trading environment can be expected to result in increased economic activity, more investment and more employment. This will lead to more imports of virtually all types of goods and will raise revenues above what might otherwise be expected.

A second possible source of additional revenues is due to greater compliance as a result of the lower incentives for smuggling when tariff rates are reduced. Obviously, the potential size of this revenue dividend depends upon the existing levels of smuggling and the extent to which a price advantage for legal imports emerges with lower tariff rates. These are difficult to estimate, but there is some anecdotal evidence to suggest that the gains may be substantial.

3.3. Key Questions—The Lists of Tariff Lines

The CEPT process requires governments to allocate all tariff lines or categories into one of three lists:

- Inclusion list—which includes goods for which the CEPT rates will be reduced either along “normal” or “fast” tracks;
- Temporary exclusion list—which is to be made up of goods that are viewed as too sensitive to be subject to immediate rate reductions; and
- General exclusion list—which is intended to include a relatively small number of goods for which trade is restricted on the basis of safety or cultural reasons.

The temporary exclusion list is indeed only temporary. Based on our current understanding, 20 percent of the goods on this list will be phased into the inclusion list year by year over a period of five years. (It is not clear when this process must begin, or whether it may be delayed for up to three years.) Furthermore, it appears that the specific goods being phased in during each year are not identified at the outset.

It is important to recognise that goods on the temporary exclusion list would not be eligible for the lower CEPT tariff rates if exported to other ASEAN member states.

Reasons for putting virtually all goods on the inclusion list

Officials have been considering the composition of the inclusion and exclusion lists. There are strong reasons why the government should put virtually all goods on the inclusion list, or to put in another way, to put very few, if any, goods on the exclusion list.

There is, however, one view being put forward by some that the inclusion list should consist mainly of goods for which there are low or non-existent tariff revenues. The idea is to minimise any potential adverse impact on tariff revenues. This approach would essentially be an attempt to delay to the maximum extent possible Cambodia’s effective integration into AFTA. As such, it would likely be costly for the country, mainly because it would delay establishing a more favourable environment for investment.

Making Cambodia a viable base for exports to ASEAN members

This is certainly one of the most important economic reasons for joining ASEAN. But Cambodia will be a potential site for ASEAN-oriented investment *only* for goods that can be exported to member countries at the lower CEPT tariff rates. For this to happen, two conditions must be met. The goods must be on the inclusion list *and* the transitional CEPT rate must be 20 percent or less.

The most effective way to establish Cambodia's place as a potential investment site would be to ensure that almost all tariff lines are immediately placed on the inclusion list, and that the maximum rates are reduced to no more than 20 percent. (The issue of normal and fast track reductions is examined below. In any case, there is nothing in the AFTA/CEPT agreement that would preclude Cambodia from reducing rates in this way.)

Competition with new ASEAN members

As one of four new ASEAN members, Cambodia, Laos, Myanmar and Vietnam would become available for ASEAN-oriented investment at more or less the same time. Although there are some important differences between each of these countries, there are also a number of similarities in their economies. This is an unusual situation and raises some interesting concerns.

It is likely that of the new ASEAN members, one or two will emerge as relatively more attractive investment centres than the others. This is because, as investors seek to locate ASEAN-oriented investment in one of the low-wage, new members, there will be a tendency to choose sites where other new investors are starting and growing. In other words, in this type of endeavour, success breeds success.

The delay in Cambodia's membership in ASEAN means that the other new members will have something of a head start in this process. The difficulties that led to the delay have themselves raised concern among potential investors. This means that if Cambodia wishes to emerge as one of the more attractive platforms for investment, it will need to make up for the delays and the adverse effects of the recent difficulties. The approach to integration into AFTA/CEPT will likely be an important part in this process.

This should include a rapid and comprehensive integration into the AFTA/CEPT policy framework, thereby ensuring the best possible prospects for ASEAN-oriented investment. It also requires improved stability and predictability in the conditions facing investors.

Increasing the stability in the economic environment

The government may believe with a high degree of confidence that in no more than five to eight years, virtually all goods will be on the inclusion list, and that within 10 years tariff rates will be down to the 0 to 5 percent range. However, the longer and less clearly defined this process is, the less confidence investors will have. There is certainly a great deal of experience from other countries that during periods of significant policy change, investment decisions tend to be deferred—even when governments have announced firm commitments to phase in changes.

It is accepted that stability and transparency are two essential characteristics of an effective industrialisation strategy. If the implementation of the CEPT system entails a large temporary exclusion list, there will be a great deal of instability and uncertainty in the policy framework, especially during the next five to eight years, when these goods would be phased into the inclusion list.

“Fast track” and “normal track” issues

There are several points to consider regarding the so-called “fast track” options.

- The first is that the CEPT agreements make explicit that there is in principle nothing limiting any country from reducing rates more rapidly than indicated. Cambodia would seem to have a virtually free hand in designing a phase-in process, as long as it takes no longer than intended up to the 10-year framework being discussed. This would include the immediate (or rapid) reduction of maximum rates to no more than 20 percent.
- A second issue concerns the speed with which the targets would be met after the first year. The economic arguments raised here all point towards as rapid an introduction as is possible. However, the government’s position should also take into account a variety of political factors. After ensuring that revenue impacts are addressed, for example by relying in the immediate period much more on excise taxes, the following position would seem to offer a suitable balance:

If virtually all goods are included on the inclusion list and virtually all maximum rates are reduced to no more than 20 percent at the outset, then a phased five-year programme in line with what has been AFTA practice would be acceptable. This would have the advantage that tariffs for almost all goods would be on a largely similar pattern. And since the amount of reductions, from no more than 20 percent to 0 to 5 percent, would not be large, investors could make plans on the basis of a reasonable degree of stability.

3.4. Will the Investors Come? Resources Needed for Investment in Social and Physical Infrastructure

There is no question that economic growth and development is now limited by resource deficiencies, for example, in electricity supply, labour force skills and effective government. As a result, there are some who suggest that implementation of the AFTA/CEPT provisions should be delayed as long as possible in order to address shortcomings with Cambodia’s labour force and physical infrastructure. This is the thinking that lies behind at least some of the proposals to put a high proportion of tariff lines on the temporary exclusion list.

However, this view misses a fundamental point—Cambodia will need to generate substantial resources if these shortcomings are to be effectively tackled, and this can only be achieved through higher rates of real economic growth. Donor assistance may continue to be available to help with this process, but it is unreasonable to expect that these resources will be anywhere near sufficient to meet these needs.

The only way in which the government can expect to generate the resources required will be through more rapid economic growth. And it is clear that reliance will have to rest on significantly increased levels of investment—both domestic and foreign.

It is understandable to question whether investors will respond to an improved economic environment in Cambodia. As has been noted above, the present situation is somewhat unusual. It is expected that Cambodia will soon be in competition with Myanmar, Laos and Vietnam to establish itself as a successful location for ASEAN investment. Failure here may have negative repercussions for many years to come. Right now, all that can be done is to prepare for implementation when the opportunity becomes available.

It is impossible to say how much and how quickly investment will increase if the CEPT system is quickly and effectively introduced. This will also depend upon a host of other factors. But it is possible to be reasonably confident that if a strong economic environment is not in place, much less investment will take place.

Chapter Five

Regional Integration for Sustainable Development in Cambodia

Toshiyasu Kato

Cambodia embarked on its transition from a command to a market-oriented economy in the midst of the globalisation of the world economy. It has already taken extensive unilateral liberalisation measures in trade and investment in the past few years. Although full membership of the Association of Southeast Asian Nations (ASEAN) was temporarily postponed in July 1997, Cambodia is still committed to integrate itself with the ASEAN economies. The government has also taken steps to join the World Trade Organisation (WTO), preparing for its accession in the future. Cambodia is without doubt accelerating the pace of its integration with the regional and world economies.

Although economic integration is expected to bring new opportunities for Cambodia, it also poses new challenges for policy-makers. The challenges are enormous particularly as the capacity and experience of managing an integrated market economy are still being developed. Some developing countries have benefited enormously from integrating themselves with the world economy in the last three decades. Policy-makers in these countries managed to successfully translate the benefits of economic integration into raising their people's standards of living. A large number of developing countries, however, have not reached the same level of success. Some have apparently failed to translate the force of globalisation and integration into the development of their countries.

This paper intends to discuss implications of regional economic integration for sustainable development in Cambodia. What is the nature of regional economic integration, particularly in the ASEAN Free Trade Area (AFTA)? How, and to what extent, would joining AFTA affect the Cambodian economy? What are challenges to translate the benefits of regional economic integration effectively and efficiently into sustainable development in Cambodia? What are policy options to meet the challenges of regional economic integration? These are the questions that the current paper seeks to answer. The main contention of this paper is that the high level of coherence and coordination among public policies towards regional economic integration is required to achieve the multi-dimensional objectives of sustainable development.

Section one of the current paper discusses the concept of economic integration with special reference to ASEAN/AFTA, the nature of regional integration, as well as providing a background for the following sections. Section two provides an overview of trade and investment patterns for the Cambodian economy. It also presents a cross-country study of

Cambodia's comparative advantage with the ASEAN countries. It is hoped that this will provide information in shaping integration strategies for sustainable development in Cambodia. Building on the background analysis above, section three discusses key issues to achieve sustainable development in Cambodia: 1) economic growth with equity; 2) agricultural and rural development; and 3) industrial and service sector development. Section four seeks policy options to meet the challenges, with a focus on policy coherence and coordination.

1. Regional Economic Integration

1.1. Regional Economic Integration

Economic integration comprises legal arrangements among nations for economic transactions and activities across national boundaries. Regional integration is a type of economic integration in which a set of nations within a certain region set up preferential arrangements, typically on international trade. The word "preferential" is key to understanding regional integration, as it implies that such agreements are extended only to signatory nations and thus exclude non-signatory ones.

Regional integration may be classified in two broad categories: 1) modest regional integration and 2) deep regional integration (de Melo & Panagariya 1993). Modest integration seeks only a preferential trade arrangement (PTA) or free trade area (FTA). PTA implies that import tariffs are set at positive though lower rates with members than with non-members. FTA is a step forward from PTA, in that zero tariffs with members and positive tariffs with the rest of the world are set. AFTA is a case of modest integration. Deep integration envisages either a customs union, in which members set common external tariffs, or a common market in which free movement across national boundaries for capital, labour, services and firms, in addition to trade in goods, is established. The single market of the European Union is an example of deep regional integration.

Economic integration may be arranged beyond the regional level. In fact, after the Second World War, multilateral trade agreements have been negotiated and implemented by the General Agreement on Tariffs and Trade (GATT), which has now evolved into its successor the World Trade Organization (WTO). The general rule of GATT/WTO is characterised by non-discrimination, and is stipulated in two clauses: most-favoured nation (MFN) and national treatment (WTO 1995). MFN is concerned with non-discrimination among imported goods from different countries. It essentially means that members are bound to grant to the products of other members treatment no less favourable than that accorded to the products of any other country. National treatment is concerned with non-discrimination between imported and domestically produced goods. It requires all members to treat imported goods no less favourably than the equivalent domestically produced goods once imported goods have entered markets of member countries. It is well recognised that tariff reduction under the non-discriminatory approach of GATT/WTO has spurred enormous expansion of world trade in the last four decades.

It should be noted that regional trading arrangements such as AFTA involve a discriminatory element against non-members, because preferential treatments are applicable only for member countries. In this sense, regional integration contradicts the non-discriminatory principle of MFN treatment in GATT/WTO. However, regional trading arrangements in the form of customs unions and FTAs are exempt from the MFN clause under GATT/WTO, since closer integration within regional countries is expected to promote freer trade.¹ In either case, regional arrangements are required to treat non-members no more restrictively than the treatments they received before the group was set up.

¹ Whether regional integration would enforce or undermine the effectiveness of multilateral trading systems envisaged by GATT/WTO is a subject of heated debate among economists. De Melo & Panagariya (1993) have collected theoretical and empirical studies on this issue.

1.2. ASEAN Free Trade Area (AFTA)

The formation of AFTA was a response of the ASEAN countries to the emergence of regionalism in North America and Europe in the late 1980s.² Having observed the formation of the North American Free Trade Area (NAFTA) and the single market of the European Community (EC), ASEAN countries expressed concerns that they might be diverted away from North American and European markets, and thus needed to expand regional markets to maintain the dynamic growth and development of previous decades.

Indeed, international trade within the ASEAN countries, called intra-ASEAN trade, formed only a small portion of total ASEAN trade. For instance, intra-ASEAN exports accounted for only 17.8 percent and 18.5 percent of total ASEAN exports in 1980 and 1990 respectively (UNCTAD 1996). It is clear from these figures that the ASEAN countries relied heavily on international trade with countries outside the Southeast Asian region. Another factor which motivated ASEAN to form a free trade area was the adoption of liberal trade and investment policies, particularly the promotion of foreign investment since the 1980s. The similarity of policies in the regional countries helped the emergence of the common interests to attract foreign investment (Tan 1996).

The implementation of the Common Effective Preferential Tariffs (CEPT) scheme is the main mechanism to create AFTA.³ Under the CEPT scheme, all member countries are required to reduce import tariffs to levels below 5 percent within 10 years, and to remove non-tariff barriers such as quotas and licences. The CEPT agreement covers a broad range of items, including manufactured and agricultural goods. It should be noted that the services trade is not included in the CEPT scheme. In addition, each member country is allowed to submit exception and exclusion lists of certain products. Tariff concessions from other ASEAN countries are granted to a country if: 1) the product satisfies the ASEAN content requirement of 40 percent; 2) the product has been listed on the inclusion list of both export and import countries and has a tariff rate of 20 percent or below; and 3) the product has a programme of tariff reductions approved by the AFTA Council. The CEPT reduction schedule of the ASEAN-7 is summarised in Table 5.1 overleaf. Cambodia's current tariff rates for each item are also shown in the same table.

2. Foreign Trade and Investment—Overview

The essence of the CEPT scheme under the AFTA agreements is the reduction and elimination of import tariffs on trade in goods within the ASEAN region in the coming 10 to 15 years. The reduction of import tariffs will change incentives for producers in each country and affect the volume and pattern of foreign trade in the region. It will also influence the pattern of foreign investment. It is important, therefore, to understand the characteristics of foreign trade and investment for Cambodia's policy making toward ASEAN/AFTA. This section provides an overview of foreign trade and investment in Cambodia.

2.1. Foreign Trade in Cambodia

Trade patterns

Natural resource-based commodities such as rubber and wood (logs and sawn timber) comprise a large proportion of exports from Cambodia. In 1996, exports of rubber and wood accounted for 10.7 percent and 49.8 percent, respectively (Table 5.2 overleaf). However, the percentage share of non-traditional exports in total domestic exports grew rapidly in 1995 and

² In North America, the bilateral negotiation of the free trade area between Canada and the United States reached agreement in 1989, and was further extended to include Mexico as the NAFTA in 1994. The European Community reached agreements to create a single market in 1992.

³ A succinct description of the CEPT scheme can be found in Chhon & Aun (1996).

Table 5.1. Cambodia's Import Tariffs and ASEAN-7 CEPT Reduction

Chapter	Sector	Cambodia's import tariffs	ASEAN-7 CEPT reduction schedule							
			1996	1997	1998	1999	2000	2001	2002	2003
25-27	Mineral products	15	2.50	2.47	2.22	2.18	1.95	1.95	1.87	1.81
28-38	Chemicals	0-35 ^a	3.96	3.54	3.01	2.85	2.48	2.47	2.32	2.14
71	Gems	50	5.35	4.88	4.35	4.05	3.47	3.26	3.10	2.76
72-73	Base metal and metal articles	7	5.35	4.88	4.35	4.05	3.47	3.26	3.10	2.76
90-92	Optical and musical equipment	-	5.71	5.43	4.65	4.37	3.65	3.53	3.21	2.84
15	Fats and oils	7	5.78	5.00	3.76	3.30	2.64	2.64	2.43	2.35
84-85	Machinery and electrical goods	15	5.88	5.52	4.64	4.28	3.47	3.40	3.06	2.69
06-14	Vegetable products	7-35	6.46	6.35	5.12	4.83	3.87	3.61	2.91	2.10
86-89	Vehicles	7-50	6.50	6.29	5.42	5.15	4.15	3.80	2.96	2.16
41-43	Hides and leathers	-	7.04	5.99	4.81	4.08	3.06	2.88	2.74	2.46
97-98	Antiques and works of arts	-	7.28	6.70	5.68	5.30	3.99	3.85	2.49	1.92
47-49	Pulp and paper	7	7.99	7.83	6.36	6.17	4.69	4.54	3.88	3.00
01-05	Live animals	-	8.35	8.25	6.58	6.26	4.92	4.64	3.54	2.27
68-70	Stone, cement, ceramics	35	9.56	8.63	6.93	5.50	3.92	3.81	3.43	2.92
39-40	Plastics	7	9.91	8.65	8.63	5.87	4.86	4.40	3.83	3.22
16-24	Prepared foodstuffs	35	10.13	9.63	7.99	7.32	5.78	5.47	4.17	2.71
50-63	Textiles and clothing	15	11.27	9.04	7.28	5.99	4.17	4.17	4.15	3.92
94-96	Misc. manufactured items	50	11.95	11.12	9.01	8.41	6.39	6.19	4.74	3.48
93	Arms	-	12.73	12.57	10.29	10.00	7.68	7.55	5.45	3.42
44-46	Wood and wood articles	35	12.93	11.83	10.60	8.75	6.67	5.92	4.92	4.58
64-67	Footwear	35	14.77	13.70	11.39	10.39	8.36	8.19	6.18	3.96

a No import tariffs on fertilisers and agricultural inputs. source: RGC (1999)

1996, reflecting the rapid development of the light manufacturing industry such as garments. As is shown below, the development was primarily driven by foreign investment.

Customs import data from 1993–95 are shown in Table 5.3. Mineral fuels such as petrol, diesel oil, fuel oil and lubricants accounted for 13 percent of customs imports, followed by 11.3 percent in machines and transport equipment (motorcycles, vehicles, televisions, VCRs, etc.), and 5.2 percent in basic manufactures (construction material, fabric, cement, steel). Because a majority of beverages and tobacco were re-exported to Vietnam, only a small portion were actually retained in Cambodia.

Table 5.2. Cambodia's Major Export Products, 1992-96

	Export values (millions of dollars)					Percentage share of exports in total domestic exports ^a				
	1992	1993	1994	1995	1996	1992	1993	1994	1995	1996
Domestic exports	49	101	234	270	299	100.0	100.0	100.0	100.0	100.0
Rubber	12	11	30	41	32	24.5	10.9	12.8	15.2	10.7
Logs	25	50	124	112	53	51.0	49.5	53.0	41.5	17.7
Sawn timber	-	34	73	73	96	-	33.7	31.2	27.0	32.1
Soybeans	2	-	-	-	-	4.1	-	-	-	-
Maize	1	-	-	-	-	2.0	-	-	-	-
Fishery products	-	-	-	1	4	-	-	-	0.4	1.3
Sesame	2	-	-	-	-	4.1	-	-	-	-
Kapok fibre	0	-	-	-	-	0.0	-	-	-	-
Other traditional exports	7	6	7	-	1	14.3	5.9	3.0	..	0.3
Non-traditional exports	-	-	-	43	113	-	-	-	15.9	37.8
Re-exports	-	117	228	540	361	-	-	-	-	-
Total exports	51	219	462	809	659					

a Domestic exports is defined as total exports minus re-exports. source: World Bank (1997)

Trading partners

Recent data on Cambodia's exports by destination and imports by country of origin do not appear to have been published officially. These data therefore have to be constructed from the trade data of Cambodia's trading partners, which were compiled in the United Nations COMTRADE system. An attempt at this by the World Bank is reported in Tables 5.4 and 5.5 overleaf. In 1994, Cambodia's exports to the ASEAN-5 accounted for 76.6 percent of total exports, while its imports from the ASEAN-5 were 76.4 percent of total imports. Data in the tables reveals that the ASEAN-5 (Thailand, Singapore, Malaysia, Indonesia and Philippines) was Cambodia's largest trading partner in terms of both exports and imports.

Table 5.3. Cambodia's Customs Imports, 1993-95

Commodities	Import values (millions of dollars)			Percentage share of total imports			Percent change of import values from prev. year	
	1993	1994	1995	1993	1994	1995	1994	1995
0. Food and live animals	27	31.5	33.8	0.7	5.7	3.6	1,066.7	7.3
Food products	27	11.6	17.8	0.7	2.1	1.9	329.6	53.4
Sugar	0.0	13.8	6.4	0.0	2.5	0.7	-	-53.6
Monosodium glutamate	0.0	6.1	9.6	0.0	1.1	1.0	-	57.4
1. Beverages and tobacco	73.8	116.5	211.5	20.4	21.1	22.7	57.9	81.5
Cigarettes	60.0	95.9	192.5	16.6	17.3	20.7	59.8	100.7
Beer	10.0	14.7	14.7	2.8	2.7	1.6	47.0	0.0
Non-alcoholic drinks	3.8	5.9	4.3	1.1	1.1	0.5	55.3	-27.1
2. Crude materials (excl. fuels)	0.0	0.0	0.0	0.0	0.0	0.0	-	-
3. Mineral fuels	38.8	65.6	120.2	10.7	11.9	12.9	69.1	83.2
Petrol	17.7	29.0	58.3	4.9	5.2	6.3	63.8	101.0
Diesel oil	18.4	30.4	51.0	5.1	5.5	5.5	65.2	67.8
Fuel oil	2.7	3.2	6.4	0.7	0.6	0.7	18.5	100.0
Lubricants	0.0	3.0	4.5	0.0	0.5	0.5	-	50.0
4. Animal, vegetable oil, fat	0.0	0.5	1.7	0.0	0.1	0.2	-	240.0
Cooking oil	0.0	0.5	1.7	0.0	0.1	0.2	-	240.0
5. Chemicals, related prod.	0.7	7.7	6.9	0.2	1.4	0.7	1,000.0	-10.4
Alcohol	0.7	7.7	6.9	0.2	1.4	0.7	1,000.0	-10.4
6. Basic manufactures	93.7	77.1	48.4	25.9	13.9	5.2	-17.7	-37.2
Construction material	24.2	20.8	19.2	6.7	3.8	2.1	-14.0	-7.7
Fabric	69.5	36.2	12.6	19.2	6.5	1.4	-47.9	-65.2
Cement	0.0	12.3	12.3	0.0	2.2	1.3	-	0.0
Steel	0.0	7.8	4.3	0.0	1.4	0.5	-	-44.9
7. Machines, transport equip.	72.1	96.7	105.3	20.0	17.5	11.3	34.1	8.9
Motorcycles	13.3	29.0	36.0	3.7	5.2	3.9	118.0	24.1
Vehicles	18.5	12.0	22.0	5.1	2.2	2.4	-35.1	83.3
Vehicle parts	4.3	3.2	6.8	1.2	0.6	0.7	-25.6	112.5
VCRs	15.8	23.1	14.9	4.4	4.2	1.6	46.2	-35.5
Televisions	10.3	21.2	17.3	2.9	3.8	1.9	105.8	-18.4
Radio cassette recorders	4.7	4.3	4.0	1.3	0.8	0.4	-8.5	-7.0
Refrigerators	1.1	1.3	1.8	0.3	0.2	0.2	18.2	38.5
Generators	4.1	2.6	2.5	1.1	0.5	0.3	-36.6	-3.8
8. Misc. manufactured goods	20.7	11.9	17.2	5.7	2.2	1.8	-42.5	44.5
Clothing	20.7	11.9	17.2	5.7	2.2	1.8	-42.5	44.5
9. Goods not classed by kind	28.0	79.2	306.1	7.7	14.3	32.9	182.9	286.5
Gold	28.0	78.4	305.0	7.7	14.2	32.8	180.0	289.0
Silver	0.0	0.8	1.1	0.0	0.1	0.1	-	37.5
Other (not classified above)	30.8	66.4	78.8	8.5	12.0	8.5	115.6	18.7
Total	361.3	553.1	929.9	100.0	100.0	100.0	53.1	68.1

Source: World Bank (1997)

Comparative advantage of Cambodia and the ASEAN countries

A cross-country comparison of comparative advantage in Cambodia and ASEAN countries provides information for understanding regional trade patterns. The index of revealed comparative advantage for exports (RCAX) was calculated and is shown in Table 5.6 (see pages 72 and 73).⁴ The table summarises the RCAX index of the top 10 export commodities in Cambodia and the ASEAN-9 countries in 1991–92. Export commodities are classified by Standard International Trade Classification (SITC) at the three-digit level. Only the top 10 export commodities of each country in 1991–92 are reported due to the availability of cross-country data.

Table 5.4 Cambodia's Exports by Destination, 1989-94

	Export values (millions of dollars)						Percentage share of total Cambodian exports					
	1989	1990	1991	1992	1993	1994	1989	1990	1991	1992	1993	1994
ASEAN-5	11.2	28.7	22.6	110.1	131.7	185.8	56.5	69.3	41.2	65.9	50.3	76.6
Thailand	3.5	11.6	11.6	93.1	96.4	126.1	17.5	28.0	21.1	55.8	36.8	52.0
Singapore	-	-	-	-	20.8	32.4	-	-	-	-	7.9	13.4
Malaysia	7.7	16.4	10.1	16.7	13.3	26.5	38.9	39.4	18.4	10.0	5.1	10.9
Indonesia	0.0	0.8	0.9	0.2	1.2	0.7	0.1	1.9	1.7	0.1	0.5	0.3
Philippines	-	-	-	-	-	0.1	-	-	-	-	-	0.1
Other Asia and Pacific	3.3	4.7	6.2	15.0	84.6	16.7	16.7	11.3	11.3	9.0	32.3	6.9
Japan	2.3	3.5	5.5	9.4	82.3	8.8	11.5	8.4	10.0	5.6	31.4	3.6
Hong Kong	0.0	0.4	0.2	0.6	0.8	4.2	0.0	0.9	0.4	0.3	0.3	1.7
India	-	0.7	-	4.7	0.0	2.1	-	1.6	-	2.8	0.0	0.9
China	1.0	0.2	0.5	0.2	1.2	1.0	5.1	0.4	0.9	0.1	0.5	0.4
Australia	-	0.0	0.0	0.1	0.3	0.6	-	0.0	0.1	0.1	0.1	0.2
North America	0.3	0.1	1.2	5.8	1.5	1.3	1.6	0.2	2.1	3.5	0.6	0.6
United States	0.3	0.1	-	0.1	0.7	1.2	1.6	0.2	-	0.1	0.3	0.5
Canada	-	-	1.2	5.7	0.8	0.1	-	-	2.1	3.4	0.3	0.1
Europe	0.5	1.0	19.6	30.1	31.2	20.1	2.6	2.5	35.8	18.0	11.9	8.3
Germany	-	-	16.7	26.7	29.2	13.5	-	-	30.5	16.0	11.2	5.6
France	0.2	0.9	2.9	3.4	0.8	4.0	0.8	2.2	5.2	2.0	0.3	1.7
United Kingdom	0.4	0.1	0.1	0.0	1.2	2.5	1.8	0.2	0.1	0.0	0.4	1.0
Rest of the World	4.5	6.9	5.2	6.0	13.1	18.7	22.6	16.8	9.5	3.6	5.0	7.7
Total	19.9	41.5	54.7	167.0	262.0	242.7	100.0	100.0	100.0	100.0	100.0	100.0

Source: Calculations based on the United Nations COMTRADE system

The RCAX index informs us that Cambodia's comparative advantage was revealed primarily in natural resource-based products (rubber, wood, timber) and labour-intensive, light manufacturing products such as garments in 1992. The structure of comparative advantage appears to have shifted away from natural resource-based products towards light manufacturing products from 1992 to 1996, as more recently available trade data in Cambodia indicates (Table 5.2 above).

It should be noted that though Cambodia is richly endowed with agricultural land and water resources relative to other regional economies, few commodities in the agriculture and fishery sectors, except for fresh and frozen shellfish, were ranked in the top 10 commodities. This may imply that potential comparative advantage in the agricultural products has not yet been developed in Cambodia.

⁴ RCAX is an index which is often used to indicate the structure and change of comparative advantage. A country is said to have a comparative advantage in a commodity if the RCAX of that commodity is greater than one.

Table 5.5. Cambodia's Imports by Country of Origin (including re-exports), 1989-94

	Import values (millions of dollars)						Percentage share of total Cambodian imports					
	1989	1990	1991	1992	1993	1994	1989	1990	1991	1992	1993	1994
ASEAN-5	14.8	13.1	11.9	98.2	600.5	734.8	41.5	32.3	29.3	20.8	76.0	76.4
Singapore	-	-	-	-	369.1	384.4	-	-	-	-	46.7	40.0
Thailand	0.1	0.9	4.6	65.8	179.3	259.8	0.3	2.1	11.4	13.9	22.7	27.0
Malaysia	0.0	0.1	1.8	8.8	12.4	46.1	0.1	0.3	4.5	1.9	1.6	4.8
Indonesia	14.7	10.4	5.4	23.0	39.6	44.2	41.2	25.7	13.4	4.9	5.0	4.6
Philippines	0.0	1.7	0.0	0.6	0.0	0.3	0.0	4.2	0.0	0.1	0.0	0.0
Other Asia and Pacific	8.9	9.6	17.3	324.8	117.4	141.5	24.8	23.6	42.6	68.7	14.9	14.7
Japan	3.6	4.5	6.7	224.3	49.4	63.3	10.2	11.2	16.5	47.4	6.3	6.6
China	1.9	1.8	2.2	12.8	20.3	35.3	5.4	4.6	5.3	2.7	2.6	3.7
Hong Kong	1.6	1.6	5.3	22.5	30.8	32.2	4.4	4.1	13.1	4.8	3.9	3.3
Australia	0.4	1.4	3.1	61.8	8.5	10.0	1.1	3.4	7.6	13.1	1.1	1.0
Taiwan	-	-	0.0	3.1	6.9	-	-	-	0.0	0.7	0.9	-
India	1.3	0.1	0.0	0.2	1.4	0.8	3.8	0.3	0.0	0.0	0.2	0.1
North America	0.0	0.1	0.0	19.7	19.3	11.5	0.1	0.1	0.1	4.2	2.4	1.2
United States	0.0	0.0	0.0	16.0	15.7	7.4	0.1	0.1	0.0	3.4	2.0	0.8
Canada	0.0	0.0	0.0	3.7	3.7	4.1	0.0	0.0	0.1	0.8	0.5	0.4
Europe	2.9	3.5	7.8	20.4	27.5	50.1	8.0	8.6	19.1	4.3	3.5	5.2
France	2.0	2.6	4.3	13.4	20.5	42.6	5.6	6.5	10.5	2.8	2.6	4.4
Germany	-	-	2.8	4.8	2.3	4.0	-	-	6.8	1.0	0.3	0.4
United Kingdom	0.9	0.9	0.7	2.2	4.7	3.5	2.4	2.1	1.8	0.5	0.6	0.4
Rest of the world	9.1	14.3	3.6	10.0	25.2	23.7	25.5	35.4	8.8	2.1	3.2	2.5
Total	35.7	40.5	40.6	473.0	789.9	961.6	100.0	100.0	100.0	100.0	100.0	100.0

Source: Calculations based on the United Nations COMTRADE system

Export diversification

The export pattern of Cambodia may be also characterised by its high concentration of exports to a small set of commodities (Table 5.7 on page 74). In 1992, Cambodia exported only 19 products at the three-digit SITC level, where the total number of products is 239. The concentration index stood at 0.51, the highest among the regional economies where data are available.

2.2. Foreign Investment in Cambodia

The Cambodian economy attracted a significant amount of foreign direct investment (FDI) since its liberalisation in the 1990s. FDI in Cambodia increased from \$80 million in 1994 to \$240 million in 1996. The ASEAN-5 countries appear to have been major players in Cambodia in terms of FDI, too (Table 5.8 on page 75). FDI from other Asian countries such as Taiwan, Hong Kong, and China was also notable, and that from the United Kingdom and France accounted for a large amount of investment in Cambodia.

An overview of foreign trade and investment in Cambodia reveals that ASEAN countries were by far the largest trading partners as well as the largest investors in Cambodia. Joining AFTA and implementing the CEPT scheme is, therefore, likely to have significant implications for Cambodia's trade, investment and the economy. The study also revealed that Cambodia's comparative advantage was revealed in natural resource-based products as well as in labour-intensive manufacturing products. The relative abundance of agricultural land indicates that potential comparative advantage, however, appears to exist in agricultural and agro-processing products.

Table 5.6. Structure of Comparative Advantage: Cambodia and ASEAN, 1992 (RCAX and the percentage share of commodity exports in total exports)

SITC	Commodities	Cambodia		Myanmar		Vietnam		Indonesia		Philippines		Thailand		Malic	
		RCAX	share	RCAX	share	RCAX	share	RCAX	share	RCAX	share	RCAX	share	RCAX	share
036	Shellfish fresh, frozen	3.0	1.1	11.5	4.1	38.2	13.6	7.0	2.5	8.7	3.1	13.4	4.8		
037	Fish, prepared, preserved														
042	Rice			60.1	7.8	65.2	8.4					20.1	3.8		
054	Vegetables, fresh			30.4	16.2							33.3	4.3		
057	Fruit, nuts, fresh, dried					4.2	2.5			5.5	3.3	6.0	3.2		
071	Coffee and substitutes					11.3	2.6								
074	Tea														
222	Seeds for 'soff' fixed oil	11.5	3.2	12.1	3.3	9.3	2.6								
232	Natural rubber, gum	94.0	10.9					27.4	3.2			29.9	3.5	21.8	
247	Other wood, rough	175.1	39.2	70.9	15.9									18.0	
248	Wood shaped, sleepers	11.9	6.3	11.7	6.2	6.9	3.7							7.2	
287	Base metal ores							7.1	2.7						
332	Coal, lignite and peat					9.2	4.8								
333	Crude petroleum					5.6	27.8	3.5	17.6						2.0
334	Petroleum products, refined							1.5	3.5						
341	Gas, natural and manufactured							13.0	13.0					3.1	
424	Fixed vegetable oil, non-soft									33.9	4.2			42.7	
634	Veneers, plywood, etc							36.6	10.3						
653	Woven man-made fibre fabric							4.8	3.4			3.8	2.9		
667	Pearls, precious stones			13.4	10.5										
752	Automatic data processing equip.														
759	Office machinery, parts											3.1	4.9	2.6	
761	Televisions														
762	Radio broadcast receivers														
763	Sound recorders														
764	Telecom equipment, parts									1.8	3.4				
772	Switch gears, parts														
773	Electrical distributing equipment														
776	Transistors, valves, etc									5.2	2.4				
778	Electrical machinery									5.2	10.5	2.0	4.0	6.9	

842	Men's outerwear, unknitted	15.9	9.3	8.4	4.9	4.9	2.5	4.2	3.6	3.7	3.2
843	Womens outerwear, unknitted	4.5	3.9	5.7	4.9	4.9	2.9	4.2	3.6	3.7	3.2
844	Undergarments, unknitted	45.2	11.3	2.2	2.2	2.3	2.5	4.2	3.6	3.7	3.2
845	Outerwear, knitted non-elastic	4.4	3.7	2.6	2.6	2.3	2.9	4.2	3.4	3.8	3.0
846	Undergarments, knitted			9.3			4.5	7.6	3.3	3.8	3.0
851	Footwear										
896	Works of art										
931	Special transactions			7.7	15.9	8.0					

Source: CDR calculations based on UN (1993)

3. Key Issues and Challenges

The goal of sustainable development

The goal of sustainable development in Cambodia is to raise the Cambodian people's standards of living or quality of life. As this goal is centred around people's living standards, it necessarily involves multi-dimensional objectives: 1) income growth with equity, particularly income growth of the poor; 2) improved health and nutrition; 3) better education; and 4) regeneration of the environment. From this perspective, economic integration is viewed as a means to achieve sustainable development in Cambodia. In the policy context, any policy measures towards economic integration must be addressed, coordinated and implemented to achieve the central goal of development—raising the standard of living of people in Cambodia. The key issues discussed below are therefore directly associated with sustainable development.

3.1. Economic Growth with Equity

Why does equity matter?

Economic integration will promote economic growth and raise income per capita at the national level. However, there is no guarantee that the benefits of economic integration will be broadly shared among the people. It might happen in Cambodia that a small number of rich people will enjoy a large portion of benefits from economic integration, at the expense of the living standards of poor and vulnerable people.

Achieving equity of distribution can improve the standards of living of the Cambodian people for at least three reasons. First, eradication of poverty will be more effective when benefits from growth reach the majority of poor people than otherwise. Second, equity tends to curb social and political tensions, which often cause political and economic instability and consequently undermine the potential for economic growth (Alesina & Peroti 1994). Third, it is not appropriate on ethical grounds to impoverish people who are already poor for the benefit of the rich.

The status of distribution in Cambodia and ASEAN

Unequal distribution is typically measured by either the Q5/Q1 ratio or the Gini index.⁵ As the two indicators usually correlate positively, the following discussions employ only the Gini index as a distribution indicator. Table 5.9 (see page 76) presents the distribution of income and expenditure in Cambodia and some ASEAN countries. According to the data, the Gini index of Cambodia measured by consumption expenditures per individuals was

⁵ The Q5/Q1 ratio is the income (or expenditure) of the highest 20 percent of the population as a proportion of that of the lowest 20 percent. As the ratio becomes higher, the distribution becomes more unequal. The Gini index is derived from the Lorenz curve. It ranges from 0 (perfect equality) to 100 (perfect inequality).

Table 5.7. Export Concentration Index for Cambodia and ASEAN

	Number of exported products (SITC three-digit levels) ^a			Concentration index (HH) ^b (0=minimum 1=maximum)	
	1980	1992	%change 1980-92	1980	1992
Cambodia	-	19	-	-	0.51
Myanmar	60	81	35	0.33	0.28
Vietnam	-	133	-	-	0.31
Indonesia	144	208	44	0.53	0.19
Philippines	175	187	7	0.22	0.29
Thailand	176	211	20	0.20	0.09
Malaysia	214	223	4	0.30	0.16
Singapore	232	226	-3	0.24	0.18
Brunei	45	48	7	0.68	0.59

^a Total number of products of three-digit SITC (Rev 2) level is 239; ^b Hirschman-Herfindahl index (HH) is normalised to give values ranging from 0 to 1 (maximum concentration); source: UNCTAD (1999)

37.2 in 1993–94, and had increased to 39.4 in 1996. Compared with ASEAN countries, expenditure distribution in Cambodia was more unequal than that in Laos, Vietnam and Indonesia. On the income distribution side, Cambodia was more unequal than the Philippines, Thailand, Malaysia and Singapore during the 1990s.

The change of distribution over time in the ASEAN countries also provides interesting insights on growth and equity issues. Thailand, Malaysia and Singapore achieved remarkably high economic growth during the 1980s and 1990s. Yet the performance of achieving equity in Malaysia and Singapore contrasts sharply with that in Thailand. Indeed, the Gini index of Malaysia and Singapore declined by 2.6 in Malaysia from 51.0 in 1979 to 48.4 in 1989, and by 1.7 points in Singapore from 40.7 in 1980 to 39.0 in 1989. By contrast, Thailand's Gini index increased sharply by 8.4, from 43.1 in 1980 to 51.5 in 1992.

It is a complex issue to identify why this clear difference of changing inequality even among high-performing ASEAN countries emerged in the course of the 1980s. Indeed, a recent empirical study by the World Bank found no support for the view that higher growth rates in average living standards tended to accompany worsening distribution.⁶ This observation, however, may indicate that the extent to which benefits from high growth rates reach the poor may depend on various domestic conditions inside countries and on public policies by the government. It is important therefore to investigate domestic conditions and constraints which adversely affect equity, and the public policies which are critical in achieving high growth with equity.

Achieving growth with equity in Cambodia

Recent empirical studies on the role of human capital in economic growth provide useful insights for public policy to achieve growth with equity in Cambodia. Cross-country studies have found that human capacity development through universal education and training has had a positive impact on economic growth, and in addition lessens income inequality. This finding has intuitive appeal, as higher levels of education narrow income differentials arising from skill differences, and subsequently reduce income inequality.⁷

⁶ Kuznets' "inverse-U shape" hypothesis on growth and income inequality appears to have lost its empirical ground in recent studies. The most recent and comprehensive study currently available is Ravallion & Chen (1997).

⁷ Several empirical studies on new growth theory have revealed the association between human capital accumulation and education and schooling. A comprehensive summary of theoretical and empirical studies can be found in Barro & Sala-i-Martin (1995). For a study of the relationship between growth and income inequality, see Persson & Tabellini (1994).

Table 5.8. Foreign Investment Projects Approved in Cambodia, 1996

	Number of projects approved	Foreign share of registered capital		Registered capital		Fixed assets	
		value (millions of \$)	percentage of registered capital	value (millions of \$)	percentage of registered capital	value (millions of \$)	percentage of total fixed assets
Total	189	357.07	77.2	462.72	100.0	748.21	100.0
ASEAN-5	60	104.93	77.8	134.82	29.1	325.50	43.5
Thailand	10	11.84	60.2	19.66	4.2	56.17	7.5
Singapore	19	35.08	79.8	43.94	9.5	42.89	5.7
Malaysia	25	55.46	86.5	64.12	13.9	204.49	27.3
Indonesia	6	2.54	35.8	7.10	1.5	21.95	2.9
Other Asia and Pacific	106	171.25	81.2	211.01	45.6	322.71	43.1
Taiwan	34	124.88	86.0	145.27	31.4	192.31	25.7
Japan	4	3.02	74.0	4.08	0.9	13.71	1.8
Hong Kong	22	10.93	62.4	17.52	3.8	51.25	6.9
South Korea	7	4.91	99.2	4.95	1.1	4.72	0.6
China	31	23.05	71.4	32.26	7.0	46.10	6.2
Australia	7	4.20	65.3	6.44	1.4	14.05	1.9
Sri Lanka	1	0.25	50.0	0.50	0.1	0.56	0.1
North America	7	14.05	45.3	31.00	6.7	15.78	2.1
United States	5	6.40	44.1	14.50	3.1	9.38	1.3
Canada	2	7.65	46.4	16.50	3.6	6.40	0.9
Europe	16	66.85	77.8	85.89	18.6	84.22	11.3
Germany	1	0.06	30.0	0.20	0.0	0.31	0.0
France	6	9.96	53.6	18.58	4.0	16.69	2.2
United Kingdom	6	50.32	86.9	57.91	12.5	38.00	5.1
Netherlands	1	3.08	61.5	5.00	1.1	21.90	2.9
Portugal	1	0.04	20.0	0.20	0.0	0.31	0.0
Switzerland	1	3.40	85.0	4.00	0.9	7.00	0.9

Source: CDRI calculations based on data from the Cambodia Investment Board

Table 5.9. Distribution of Household Income and Expenditure: Cambodia and ASEAN

Country	Year	Distribution		Measurements of inequality						
		Type ^a	Unit ^b	Q1 Low20%	Q2 4th20%	Q3 3rd20%	Q4 2nd20%	Q5 Top20%	Q1/Q5 ratio	Gini index ^c
Cambodia	1993-94	E	P	7.0	10.6	14.0	19.4	49.0	7.0	37.2
	1996	E	P	5.8	9.9	14.1	20.7	49.6	8.6	39.4
Laos	1992	E	P	9.6	12.9	16.2	21.1	40.2	4.2	30.4
Vietnam	1992	E	P	7.8	11.4	15.4	22.4	43.0	5.5	35.7
Indonesia	1976	E	P	8.0	11.6	16.0	21.9	42.5	5.3	34.6
	1978	E	P	8.0	10.1	14.8	21.8	45.3	5.7	38.6
	1980	E	P	7.3	12.3	15.9	22.2	42.3	5.8	35.6
	1981	E	P	7.7	12.7	15.7	21.8	42.1	5.5	33.7
	1984	E	P	8.3	12.5	15.2	22.0	42.0	5.1	32.4
	1987	E	P	8.0	12.9	15.6	21.8	41.7	5.2	32.0
	1990	E	P	9.2	12.1	16.2	20.6	41.9	4.6	33.1
	1993	E	P	8.7	12.3	16.2	22.1	40.7	4.7	31.7
Philippines	1957	I	H	6.5	7.8	13.6	23.6	48.5	7.5	46.1
	1961	I	H	4.2	7.9	12.1	19.3	56.5	13.5	49.7
	1965	I	H	3.5	12.5	8.0	20.0	56.0	16.0	51.3
	1971	I	H	3.6	8.1	13.3	21.0	54.0	15.0	49.4
	1985	I	H	5.2	9.1	13.3	20.3	52.1	10.0	46.1
	1988	I	P	5.2	9.1	13.3	19.9	52.5	10.1	45.7
	1991	I	H	-	-	-	-	-	-	45.0
Thailand	1962	I	H	8.0	8.6	12.1	21.5	49.8	6.2	41.3
	1969	I	H	5.1	10.1	14.4	20.3	50.1	9.8	42.6
	1975	I	H	4.9	10.1	14.8	21.8	48.4	9.9	41.7
	1981	I	H	4.3	9.4	13.9	21.3	51.1	11.9	43.1
	1986	I	H	4.2	8.7	13.1	20.9	53.1	12.6	47.4
	1988	I	H	4.1	8.5	12.8	20.4	54.2	13.2	47.4
	1990	I	H	4.0	8.3	12.5	20.0	55.2	13.8	48.8
	1992	I	H	3.7	7.6	11.6	18.6	58.5	15.8	51.5
Malaysia	1970	I	H	4.0	7.7	12.3	19.8	56.2	14.1	50.0
	1973	I	H	-	-	-	-	-	-	51.8
	1976	I	H	3.3	7.8	11.8	19.8	57.3	17.4	53.0
	1979	I	H	3.7	8.2	12.5	19.8	55.8	15.1	51.0
	1984	I	H	4.2	8.6	13.2	20.8	53.2	12.7	48.0
	1989	I	P	4.6	8.3	13.0	20.4	53.7	11.7	48.4
Singapore	1973	I	H	-	-	-	-	-	-	41.0
	1978	I	H	7.2	11.4	15.9	23.5	42.0	5.8	37.0
	1980	I	H	6.5	10.8	13.3	22.8	46.6	7.2	40.7
	1983	I	H	-	-	-	-	-	-	42.0
	1988	I	H	6.5	10.8	13.3	22.8	46.6	7.2	41.0
	1989	I	H	-	-	-	-	-	-	39.0

a E=expenditure, I=income; b P=person, H=household; c Gini index is normalised to fall between 0 (perfect equality) and 100 (perfect inequality); source: World Bank (1997), UNDP (1997)

Local conditions and constraints

As our cross-country study indicates (see Chapter One of this volume), the current level of human resources in Cambodia is among the weakest in the Southeast Asian region. The adult literacy rate in Cambodia was only 36 percent in 1995, which contrasts sharply with that in

other ASEAN countries where more than 80 percent of population are literate.⁸ Cambodia's combined gross school enrolment rate was 30 percent in 1993, by far the lowest among the 10 regional economies as well. Few would disagree that the low level of human resources in Cambodia is a legacy of the Cambodian civil war of the 1970s and 1980s.

Without doubt, public provision of universal education, particularly at the primary level, contributes to human resource development in Cambodia, and will positively affect economic growth, equitable income distribution, and poverty alleviation in the long term. However, the high expected benefits to Cambodia of public investment in education does not appear to be reflected well in education policy in Cambodia.

For example, total public spending on education in Cambodia accounted for only 1 percent of GDP in 1996. This figure is much lower than the 4.1 per cent in Malaysia, 3.1 percent in Singapore and 2.7 percent in Thailand. Looking at primary education in the ASEAN countries, public spending on primary education alone accounted for 1.4 percent of GDP in the Philippines, 1.6 percent in Thailand, and 1.7 percent in Malaysia. In terms of the quality of public education, the number of pupils per teacher in primary schools in Cambodia was 44 in 1996, the highest in the 10 regional countries where data are available (RGC 1997).

Our cross-country study also revealed that health indicators related to access to services, safe water and sanitation were also much lower in Cambodia than in other countries. Provision of public health services is highly inadequate compared with other regional economies. The low public provision of health services puts a heavy burden on the Cambodian people, who spend the highest private expenditures on health relative to GDP within the region.

Challenges

The above analysis suggests that there is a huge social development gap between Cambodia and the ASEAN countries. It sends a warning signal to Cambodia that the country urgently needs to catch up with other regional economies in the areas of education and health. Otherwise, the benefits from economic growth stimulated by regional economic integration will probably not be shared by all, particularly the poor. This will undermine the potential for high economic growth in the future. A major challenge to the government is, therefore, how to mobilise limited public resources to fill the existing gap in human resource capacity between Cambodia and the ASEAN countries.

3.2. Agricultural and Rural Development in Cambodia

There are several reasons to point to the high priority for agricultural and rural development in Cambodia. First, a majority of Cambodians live in rural areas, and most of them are involved in agriculture, fishing and forestry.⁹ Second, agricultural production, which is primarily located in rural areas, accounted for 42.7 percent of real GDP in 1996, the highest share, followed by the service (37.4 percent) and industrial sectors (19.9 percent). Third, the living standards of rural people in Cambodia are extremely low relative to people living in urban areas.¹⁰ All of these suggest that agricultural and rural development will have a significant impact on improving the living standards of a majority of the Cambodian people.

⁸ This adult literacy rate for Cambodia comes from UNDP (1996). The *First Socio-Economic Survey of Cambodia, 1993-94* (NIS 1995), however, reported that adult literacy rate to be 65.3 percent in 1993-94, though this is still the lowest among the regional countries.

⁹ In 1996, for instance, the number of rural households was estimated to be 87 percent of total households in Cambodia. In rural areas, employment in agriculture, fishing and forestry accounted for 88 percent of total employment in 1996 (RGC 1996).

¹⁰ The highest incidence of poverty is found in rural areas, where 43 percent of individuals live below the poverty line, whereas only 11 percent of individuals in Phnom Penh fall below the poverty line (World Bank 1996).

The importance of agricultural sector development is also reported in a large number of empirical studies. These studies have found that agricultural development has contributed to the development of other sectors through various channels, such as the provision of labour for the industrial sector, food for an expanding population with higher income, savings for industrial investment, markets for industrial output, export earnings to pay for imported capital goods and raw materials for agro-processing products (Timmer 1995). Furthermore, a cross-country study by the World Bank pointed out that industrial development in the East Asian countries was preceded by agricultural development (World Bank 1993).

Potential impact of AFTA

New categories of unprocessed agricultural products (UAPs) were included in the CEPT scheme of AFTA in 1994. Although the tariff reduction of UAPs does not start immediately, it does have to be added to the inclusion list in the long term. Joining AFTA is thus likely to have a significant impact on agricultural and rural development in Cambodia. Cambodia's trade policy towards AFTA needs a clear strategy to handle this issue. The selection of UAP tariff lines for the inclusion list, the temporary exclusion list and the sensitive lists under the CEPT scheme must be thought with careful consideration of domestic conditions and constraints in the agricultural sector.

Domestic conditions and constraints

As Section two indicates, comparative advantage in the agricultural sector has not been well developed, despite Cambodia's relative abundance of agricultural land. Export capacity of agricultural products is still underdeveloped. Indeed, there is great scope for improvement in agricultural production in Cambodia (Table 5.10).

Among major crops produced in Cambodia, a majority show relatively low yields within the ASEAN region. For instance, yields of rice in Cambodia were only 31 percent of those in Indonesia, the best-practice country for rice crops in the ASEAN region in 1994/95. Yields of other crops were also far behind the performance of the best-practice country, except for soybean production, in which Cambodia recorded the best performance in the ASEAN region.

The use of agricultural inputs such as labour, fertilisers, irrigation, tractors and land also affects the performance of agricultural production. Table 5.11 illustrates the intensity of input utilisation in Cambodia and ASEAN. The intensity of input utilisation was measured by each input per hectare. It is clear from the table that agricultural production technology in Cambodia recorded the least, or next to the least, intensity of factor utilisation. The use of labour, fertilisers, irrigation and machinery was extremely limited in Cambodia relative to that in other ASEAN countries. Of interest to observe, Vietnam used its abundant work force most intensively, with a massive dose of fertiliser and extensive use of irrigation, as substitutes for the use of machinery such as tractors.

Cambodia's limited access to agricultural inputs has been documented in various reports.¹¹ In addition to the inputs discussed above, limited access to credit for farmers is also one of the critical constraints to agricultural development in Cambodia. For instance, commercial bank credits to the agricultural sector accounted for only 5.8 percent of total commercial bank credits as of October 1996 (CDRI 1997). Although rural micro-credit schemes have been developed by some bilateral and multilateral donors and NGOs, the speed of development is slow and the scale is still small. Informal credit certainly exists in rural Cambodia, yet there is evidence that interest rates tend to be considerably higher for the poorest with few assets than for better-off farmers (Murshid 1997). Farmers' lack of access to technical advice, management expertise and market information has also been pointed out.

¹¹ See, for instance, FAO (1994), ADB (1996), Tickner (1996).

Table 5.10. Yields of Major Crops in Cambodia and ASEAN Countries, 1994/95

	Cambodia	Laos	Myanmar	Vietnam	Indonesia	Philippines	Thailand	Malaysia
Yields of major crops (tons per hectare)								
Rice paddy	1.4	2.7	3.1	3.6	4.3	2.7	2.3	3.1
Maize	1.7	2.2	1.7	2.2	2.3	1.5	2.8	1.8
Soybeans	2.2	0.9	0.8	1.0	1.1	1.3	1.4	0.3
Cassava	6.0	13.7	9.3	8.9	12.2	8.7	14.0	10.5
Sweet potatoes	6.0	7.7	5.5	6.1	9.5	4.8	10.1	11.0
Potatoes	-	6.7	9.4	9.6	15.6	13.4	9.3	-
Groundnuts in shell	0.6	0.9	1.0	1.2	1.3	0.8	1.5	3.7
Sugar cane	33.3	29.9	41.0	49.7	74.7	66.8	54.8	68.0
Pulses	0.6	1.9	0.7	0.7	0.9	0.8	0.8	-
Deviation from the best-practice country (highest-yield country = 100)								
Rice paddy	31	62	72	84	100	61	54	72
Maize	59	77	59	78	80	55	100	64
Soybeans	100	40	39	48	52	62	63	15
Cassava	43	98	67	63	87	62	100	75
Sweet potatoes	55	70	50	55	86	43	92	100
Potatoes	-	43	60	61	100	85	59	-
Groundnuts in shell	17	25	27	33	36	22	41	100
Sugar cane	45	40	55	66	100	89	73	91
Pulses	33	100	35	36	47	42	43	-

Source: CDR calculation based on FAO (1996)

Challenges

The above analysis seems to suggest that regional economic integration will pose enormous challenges to the agricultural sector in Cambodia. The agricultural sector in Cambodia has not yet gathered momentum to reveal its potential comparative advantage within the region. It will be exposed to stiff competition with the regional economies, where farmers have much better access to inputs, modern technology and market information. If the agricultural sector fails to improve productivity and penetrate regional markets, Cambodia will become a net importer of agricultural and related products. Improving the performance of the agricultural sector therefore is urgent in the face of regional integration.

Table 5.11. Intensity of Agricultural Input Utilisation in Cambodia and ASEAN Countries, 1994/95

	Cambodia	Laos	Myanmar	Vietnam	Indonesia	Philippines	Thailand	Malaysia
Input per hectare								
Agric. population ^a	1.9	3.7	3.3	7.4	32	3.1	1.6	0.6
Fertiliser use ^b	3.3	2.3	17.2	174.5	84.8	65.5	61.5	158.6
Irrigated land (%)	4.5	17.2	13.3	26.6	15.2	17.2	23.1	4.5
Tractors ^c	0.4	1.0	1.2	0.5	1.8	1.3	5.8	5.1
Deviation from the highest intensity country (highest intensity country = 100)								
Agric. population ^a	26	51	45	100	43	42	21	8
Fertiliser use ^b	2	1	10	100	49	38	35	91
Irrigated land (%)	17	65	50	100	57	65	87	17
Tractors ^c	6	17	21	9	32	22	100	88

a. Agricultural population = person/hectare; b. Fertiliser use = kg of mineral fertiliser consumed per hectare; c. Tractors = tractors per 1,000 hectares; source: CDR calculation based on FAO (1996)

A challenge for the government is how to articulate cross-border measures, such as trade and investment policies, to facilitate agricultural and rural development. As for the AFTA/CEPT strategies, some agricultural products may require preferential protection by import tariffs. This may ensure producers certain profits, and also provide incentives to invest in enhancing production capacity. Foreign investment in the agricultural sector may need be further promoted to supplement the shortage of domestic investment.

3.3. Development of the Industrial and Service Sectors

Economic performance

The industrial and service sectors have shown fairly good growth since Cambodia's transition to a market economy started in the early 1990s. Average annual growth rates in the industrial and service sectors between 1991 and 1996 were 11.9 percent and 8.4 percent respectively (Table 5.12). The high rates of growth in these sectors transformed the production structure of Cambodia at a rapid pace. The share of agriculture declined in real terms from 51.8 percent in 1991 to 42.7 percent in 1996, whereas that of industry increased from 15.5 percent in 1991 to 19.9 percent in 1996, and that of services from 33.1 percent in 1991 to 37.4 percent in 1996.

Challenges of regional integration

Although the overall performance of industrial development in Cambodia has been impressive, regional integration may still pose several challenges to Cambodia's industrial and service sectors. The challenges are: 1) to develop agriculture-related industries; 2) to maximise employment, maintain labour standards and review benefits in the unskilled, labour-intensive industries; 3) to assistance small- and medium-sized enterprises (SMEs); and 4) to control pollution and hazardous industrial wastes.

Domestic conditions and constraints

Industrial development maximises benefits for a country when it is based on comparative advantage. Industrialisation in Cambodia should therefore be linked to either revealed or potential comparative advantage.

The agricultural sector is one where Cambodia's potential comparative advantage appears to exist. There are several advantages to developing agro-industry and the food-processing industry in Cambodia. First, it will create employment and substitute imported processed agricultural products for domestically produced ones. In addition, it will strengthen backward links to the agricultural sector. The backward links will increase the demand for agricultural products, which will give incentives to expand production and improve productivity for a large number of farmers in rural areas. The link in turn will create demand for manufactured goods and services from farmers who are earning higher incomes.

Despite its potential capacity for development, the agricultural sector, including food-processing industries, has so far not attracted many investment projects. Table 5.13 (see page 82) illustrates this point. Among total investment projects approved by the Cambodia Investment Board (CIB) between August 1994 and December 1996, the agricultural sector accounted for 10 percent of total registered capital, 6 percent of total fixed assets and 13 percent of total employment. The challenge for the government is how to facilitate development in agriculture-related industries.

The development of the manufacturing industry has begun and gathered momentum in the labour-intensive, light manufacturing industries, particularly garments. The garment industry alone accounted for \$135 million of registered capital and created 53,000 jobs between 1994 and 1996. This sector has already revealed strong comparative advantage in the ASEAN region. With investment increasingly coming into Cambodia, this sector is expected to expand Cambodian exports, create jobs and generate income for a large number of Cambodian people. The role of government here may be to ensure that this sector will actually provide the expected benefits listed above.

Table 5.12. Cambodia's Real GDP (by industrial origin)

	GDP (at 1989 constant prices) (billions of riel)						Avg ann. growth (%) 1991-96	%share by indust. origin		%share within sector	
	1991	1992	1993	1994	1995	1996		1991	1996	1991	1996
Agriculture	135.9	138.5	137.1	137.1	145.9	148.5	1.8	51.8	42.7	100.0	100.0
Crops and rubber	79.3	79.0	77.2	70.9	82.2	82.9	0.9	30.2	23.8	58.4	55.8
Rice	47.6	46.7	48.2	38.6	47.9	47.3	-0.1	18.2	13.6	35.0	31.9
Crops/rubber	31.7	32.3	29.0	32.4	34.3	35.7	2.4	12.1	10.3	23.3	24.0
Livestock	34.5	36.9	38.0	39.5	41.1	43.8	4.9	13.2	12.6	25.4	29.5
Fishery	13.5	12.7	12.0	11.8	12.2	12.1	-2.2	5.1	3.5	9.9	8.1
Forestry	8.6	9.9	9.9	14.9	10.4	9.7	2.4	3.3	2.8	6.3	6.5
Industry	39.5	45.7	51.7	55.6	61.1	69.2	11.9	15.1	19.9	100.0	100.0
Mining/quarrying	3.0	3.2	3.4	3.7	4.0	4.6	8.9	1.1	1.3	7.6	6.6
Manufacturing	18.4	19.0	20.5	22.1	24.3	27.5	8.4	7.0	7.9	46.6	39.7
Electricity/water	0.5	0.6	0.7	0.7	0.8	0.9	12.5	0.2	0.3	1.3	1.3
Construction	17.6	22.9	27.1	29.1	32.0	36.2	15.5	6.7	10.4	44.6	52.3
Services	86.8	96.5	103.3	111	119.7	130.2	8.4	33.1	37.4	100.0	100.0
Trans. and comm.	7.0	8.1	8.9	9.7	10.7	12.2	11.8	2.7	3.5	8.1	9.4
Trade	34.4	39.9	42.3	44.8	48.8	54.6	9.7	13.1	15.7	39.6	41.9
Hotels/restaurants	1.0	1.3	1.4	1.7	1.8	2.2	17.1	0.4	0.6	1.2	1.7
Educational/health	11.0	11.0	11.5	12.5	12.9	12.7	2.9	4.2	3.7	12.7	9.8
Home ownership	16.3	17.4	18.8	20.3	21.8	23.0	7.1	6.2	6.6	18.8	17.7
Other services	17.1	18.8	20.4	22.1	23.7	25.5	8.3	6.5	7.3	19.7	19.6
GDP	262.2	280.7	292.1	303.7	326.8	347.9	5.8	100.0	100.0		
Memorandum item											
Nonind. GDP	1,336	2,509	5,414	6,131	7,200	8,200	43.7				
GDP (millions of \$)	1,900	2,002	2,245	2,340	2,923	3,125	10.5				

Source: World Bank (1997)

Regional integration will pose challenges to the SMEs, which form a majority of industrial enterprises in Cambodia. With the reduction of import tariffs under the CEPT scheme, SMEs will be exposed to severe competition with foreign competitors. Although SMEs are a pool of domestic entrepreneurs in Cambodia, their access to credit is limited just like poor farmers.

The growth of industrial output in Cambodia stimulated by regional integration will increase the generation of pollution and industrial toxic waste. Numerous studies on the environment have reported that trade liberalisation has been associated with environmental degradation in ASEAN countries (Repetto 1995). Pollution of air, soil and water by industrial waste and energy consumption will adversely affect the living standards of people in Cambodia. Here, Cambodia should take advantage of its late-comer's position to avoid and control the environmental degradation which neighbouring countries have already encountered.

4. Policy Options

The previous section discussed various challenges to Cambodia posed by regional economic integration. In this section, several points raised above are pulled together in order to seek policy options at the disposal of Cambodian policy-makers.

Table 5.13. Investment Projects Approved in Cambodia, August 1994 - December 1996

	1994	1995	1996	Total between 1994-96	Sectoral share (percentage) 1994-96
	Number of investment projects				
Agriculture	7	32	33	72	18
Industry	27	91	135	253	69
Service	5	40	24	69	13
Total	39	163	192	394	100
	Registered capital (millions of \$)				
Agriculture	119.43	70.01	81.74	271.17	10
Industry	97.41	356.79	331.99	786.19	29
Service	6.64	1,574.15	75.63	1,656.42	61
Total	223.47	2,000.94	489.36	2,713.78	100
	Fixed assets (millions of \$)				
Agriculture	59.90	69.75	96.15	225.80	6
Industry	486.59	592.54	550.76	1,629.89	41
Service	50.18	1,859.10	171.34	2,080.63	53
Total	596.67	2,521.39	818.26	3,936.32	100
	Manpower (under full production)				
Agriculture	1,709	8,775	8,523	19,007	13
Industry	17,222	32,669	57,219	107,110	76
Service	2,883	6,271	5,769	14,923	11
Total	21,814	47,715	71,511	141,040	100

Source: CDR calculation based on data provided by the CB

4.1. Policy Coherence

Few would disagree that public policies should be coherent, but in reality they are often not. Incoherent public policies tend to prevail on a larger scale in developing countries than in industrial countries, because governments in developing countries are generally subject to tighter financial and human resource constraints than those in developed countries. The economic and social cost of incoherent public policies is tremendous. Incoherent public policies simply waste a huge amount of scarce human and financial resources without achieving their objectives. Developing countries with strictly limited resources simply cannot afford it. Thus it is imperative for the Cambodian government to investigate whether new policy measures are consistent with other public policies. This way the objectives of the new policies are achieved most effectively without undermining the goals of other policies. Policies towards Cambodia's regional integration with AFTA should be considered in this context.

Coherence 1: AFTA/CEPT and growth with equity

By joining AFTA/CEPT, Cambodia will have access to the ASEAN markets which aim to eliminate import tariffs and non-tariff barriers by the year 2003 (2006 for Vietnam). This is expected to stimulate growth of the export sectors in which revealed and potential comparative advantages lie, and hence boost economic growth. However, growth will not be sustainable unless its benefits are broadly shared, as was discussed in Section three. Public investment in human resource development such education and training is thus essential to translate the benefits of integration into sustainable development in Cambodia. Provision of basic health and social services is also critical to improve the living standards of the Cambodian people as well as upgrade the capacity of human resources.

If the government fails to invest in human resources, however, regional integration may widen the gap between the rich and poor, generate a sense of inequality and unfairness among people, and heighten social and political tensions in Cambodia. This may eventually undermine the potential for attracting foreign investment and the benefits from regional economic integration.

Coherence 2: AFTA/CEPT and agricultural and rural development

The highest priority in agricultural and rural development is a national consensus in Cambodia. There are several reasons to support this, as was indicated in Section three. Although potential comparative advantage appears to exist in the agricultural sector, it has not yet been revealed and developed. A number of serious local constraints seem to prevent the development of the agricultural sector.

Naturally, a policy package which directly addresses agricultural development is most critical, but Cambodia's tariff reduction strategies under AFTA/CEPT will change the incentive structures for farmers and producers, which could enhance or undermine the effectiveness of the agricultural policy package.

On the trade and investment policy side, strategies towards AFTA may need to consider some preferential, yet time-constrained, protection of some strategic items which have the potential to turn into export products within a certain period of time. The promotion and facilitation of foreign investment in the agricultural sector should supplement trade strategies. On the agricultural and rural development side, policy making should take into account the strategies of the AFTA/CEPT scheme. In this way, both cross-border and domestic measures will complement rather than conflict with one another.

Coherence 3: AFTA/CEPT and industrial and service sector development

As discussed in Section three, industrial development appears already to have gathered momentum since Cambodia's transition to a market economy started in the early 1990s. The light manufacturing industry, such as garments, has been leading the industrial sector, and the construction industry also has expanded sharply, reflecting the construction boom after the Paris Peace Agreements in 1991. In other words, markets appear to be working reasonably well, and direct intervention in the form of tariff protection under the AFTA/CEPT scheme in Cambodia may thus not be appropriate.

Rather, the government's role in these sectors is to ensure that development will actually contribute to raising the living standards of the people by maximising the number of jobs created, exports of products, earning of foreign currency and tax payments for government revenue. No less important is that the labour standards set out in the labour law be strictly implemented to protect the living standards of workers. Industrial waste which adversely affects the environment needs to be controlled as well.

Setting quality standards for products and services is also a critical role of the government. As Klitgaard (1991) points out, quality standards will provide incentives for producers to improve the quality of products and services, and help consumers to be better informed about the quality of those products. In short, adequate quality standards will help mitigate problems arising from the asymmetry of quality information between producers and consumers, and make markets work better.

4.2. Policy Coordination

Policy coherence will never emerge without a high level of coordination among government ministries. As Kaplan (1997) points out, one of the ongoing challenges to the Cambodian

government is “building inter-ministerial arrangements that can effectively and efficiently coordinate to generate policy options, develop and share information, and provide technical input to guide Cambodia’s participation in ASEAN’s various economic initiatives.” Institution building and legal reform are one of the pre-conditions to enhance the coordinating capability of the Cambodian government. The role of the National AFTA Unit and Internal Coordination Network (ICN), which were created for inter-ministerial coordination, is critical for generating a coherent set of policy packages aimed at regional economic integration.

Coordination may be necessary between the public and the private sector as well. Preparations for ASEAN so far appear to be limited to the government. It is not clear to what extent the private sector in Cambodia has been informed about AFTA itself or about the government’s policy stance towards AFTA. As the private sector will be exposed to stiff competition within the region, information of this sort will be helpful for its decision-making to prepare for AFTA. The public sector would also benefit from exchanging views with the private sector to generate a coherent policy package towards AFTA.

5. Conclusion

The present paper seeks to discuss what challenges economic integration would pose to achieve sustainable development in Cambodia.

For this purpose, it first made clear the concept of regional economic integration, and identified foreign trade and investment as the key variables which will be directly affected by joining AFTA. It then looked at current patterns of foreign trade and investment in Cambodia. There are two main findings:

- ASEAN countries were by far the largest trading partners with as well as the largest investors in Cambodia. This indicates that Cambodia’s membership in ASEAN and AFTA is likely to have significant economic implications for Cambodia.
- Cambodia’s revealed comparative advantage was shown to lie in natural resource-based products (rubber, wood, timber) and labour-intensive manufacturing products (garments). A comparison with neighbouring countries indicates, however, that Cambodia’s potential comparative advantage may lie in agricultural and agro-processing products, an area which has not yet been well developed.

Discussing the challenges to translate the benefits of regional integration into sustainable development was the main purpose of this paper. It was emphasised that regional economic integration is a means to raise the living standards of Cambodian people, which is the goal of sustainable development.

The first challenge was to achieve high economic growth with equity. It was argued that Cambodia’s development would not be sustainable unless the benefits from regional integration and economic growth were shared by all, particularly by the poor. A key policy to maintain equity is public investment in universal education and health. Our comparative study revealed that public investment in education and health in Cambodia was much lower than that in other ASEAN countries. A challenge to the government is, therefore, how to mobilise limited resources to fill the existing gap in human resource capacity between Cambodia and the ASEAN countries.

The second challenge was to promote agricultural and rural development. Agricultural products are already included in the CEPT scheme under AFTA, and thus will be exposed to competition with the ASEAN economies in the long term. Our study found, however, that the productivity of agricultural products in Cambodia was, in general, far behind the best-practice country within the region. Farmers faced serious constraints in terms of access to various inputs, finance, technology and information. Cambodia has not yet revealed its comparative advantage in agricultural products, where its potential comparative advantage appears to exist.

pears to exist. A major challenge to the government is how to articulate AFTA/CEPT strategies to facilitate agricultural and rural development.

The third challenge was industrial and service sector development. It was argued that these sectors have been leading sectors for economic growth since economic liberalisation started. The nature of the challenges to the government here is therefore different from those in other sectors. It was argued that the government should ensure that the development of these sectors actually contributes to raising the standards of living of the Cambodian people. Setting quality standards for goods and services is also a critical role for the government to make market mechanisms work better.

Key factors in articulating regional integration policies in Cambodia are policy coherence and coordination. The multi-dimensional objectives of sustainable development require the government to articulate integration policies which are coherent with other policies serving different objectives. Policy coherence will not emerge without coordination between the ministries, and also coordination between the private and public sector. Cambodia's regional integration will contribute most effectively and efficiently to sustainable development if these conditions are met.

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Appendix One

List of Conference Papers

The following papers were presented at the Cambodia Development Resource Institute international conference *Cambodia: Challenges and Options of Regional Economic Integration*, held in Phnom Penh from 27 to 28 October 1997:

- *Cambodia in the Regional Economy: A Cross-Country Study*, Chan Sophal, Toshiyasu Kato & Long Vou Piseth (Cambodia Development Resource Institute)
- *Cambodia's ASEAN Membership: The Institutional and Legal Challenges*, Jeffrey Kaplan (ASEAN Project, UNDP Cambodia)
- *Membership in ASEAN: Public Finance and Tax Reform in Cambodia*, Kun Nhem (ASEAN Department, Ministry of Economy and Finance)
- *Cambodia: Strengthening the Foundation for Trade and Industrial Development*, James Robertson & Harold Pohoresky (Consultants for Asian Development Bank)
- *Regional Integration for Sustainable Development in Cambodia*, Toshiyasu Kato (Cambodia Development Resource Institute)
- *Lao PDR in the ASEAN Free Trade Area: Trade, Revenue and Investment Implications*, Jayant Menon (Centre of Policy Studies, Monash University)
- *Regional Integration and its Influence on the Forest Resources in Lao PDR*, Takeko Iinuma (Forest Conservation and Afforestation Project, Department of Forestry)
- *Regional Economic Integration and Macro-Economic Management in Vietnam*, Nguyen Xuan Nguyen (Central Institute for Economic Management, Ministry of Planning)
- *Foreign Trade and Investment Policies in Vietnam*, Hoang Van Thanh (Central Institute for Economic Management, Ministry of Planning)

Presentations were also made at the conference by H.E. Keat Chhon (Senior Minister in Charge of Rehabilitation and Reconstruction and Minister of Economy and Finance), H.E. Cham Prasidh (Minister of Commerce), Somchith Inthamith (ASEAN Department in the Ministry of Commerce, Laos), and Shigeru Itoga (Institute of Developing Economies, Japan).

Photocopies of conference papers other than the Cambodia-specific papers reproduced in this volume are available on request for a nominal charge. An analytical working paper based on the findings of this conference is also available—Toshiyasu Kato, Chan Sophal & Long Vou Piseth, 'Regional Economic Integration for Sustainable Development in Cambodia' (Phnom Penh: CDRI, September 1998) Working Paper 5

Appendix Two

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