LEVERAGING TRADE FOR ECONOMIC GROWTH IN CAMBODIA

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1. Introduction

No country in the world can sustain high growth without expanding trade. Openness to trade affects growth in several ways; it allows a country to exploit its comparative advantages and thereby enhances the efficiency of resource allocation, facilitates acquisition of foreign technology and knowledge and thus raises productivity, and attracts more investment, stimulating competition and improving competitiveness. Cambodia followed such a growth path during her economic take-off over the past decades, undergoing radical change from a trade regime effectively controlled by the state to one that is outward-oriented. Now that the trade sector forms the backbone of the economy, the challenge is how to make trade work for growth. This article attempts to answer two important questions: (1) Why is trade vital for Cambodia's growth path? (2) What is the right policy mix for Cambodia to make trade work for economic growth?

2. Why Is Trade Vital for Cambodia's Growth Path?

Trade and trade policy is important for Cambodia's growth path for at least three reasons: (i) trade policy transition has created favourable conditions for the next trade strategy; (ii) trade has played a significant role in the past growth process; and (iii) the international trading landscape is changing so rapidly that policy requires constant adjustment to meet the challenges of globalisation.

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2.1. Relevance of Historical Development

2.1.1 Successful Trade Policy Transition

The country's trade policy transition went through three major phases: transitional, economic reintegration and post-WTO. The first phase of policy change in the 1980s and early 1990s shifted from a regime in which the state strictly controlled the price and quantity of goods produced, imported and exported to a modern trade system that favoured the private sector and foreign investment in international trade. The transition was supported by extensive economic reform programmes aimed at creating a more open market-driven economy with outward-looking development. Pressing measures included the abolition of the state monopoly on foreign trade, the promulgation of foreign investment laws that enable private companies to engage in foreign trade, abolition of price controls, privatisation of state enterprises and other state properties and elimination of quantitative restrictions. The policy reform process was boosted by peace brought about by the Paris Agreement in 1991 and by political stability as a result of the establishment of a coalition government in 1993.

The second phase of trade policy reform started in 1994 under the slogan of reintegrating into regional and global economies. Participation and partnership in sub-regional, regional and global trade arrangements have been an integral objective in trade development and national development strategy. The ultimate goal was a more liberal trade and investment policy as a means to promote economic growth and poverty reduction. Measures included the adoption of a law on investment in 1994; a "trade relations" campaign with major trading partners; joining regional trading blocs (i.e. ASEAN and ASEAN plus FTAs) and the multilateral trading system. The major outcomes were increasing recognition and engagement in multi-level economic and trade cooperation frameworks.

In the third phase of Cambodia's trade policy transition, which started in 2004, the economy experienced high growth and rapid expansion of trade, investment and private enterprise.

Trade policy focused on (1) enhancing participation in sub-regional, regional and global economic cooperation; (2) fostering export diversification; and (3) facilitating and encouraging investment for export. Most government reform programmes and development partners' assistance concentrated on putting in place a transparent and predictable legal framework, and addressing trade facilitation issues and improving the investment climate. Measures included passing the laws and regulations required as a result of WTO accession; the adoption of a Twelve-Point Action Plan to enhance trade facilitation and the investment climate; amendment of the investment law and promulgation of laws on special economic zones; and the adoption of Trade SWAp as part of trade-related institutional strengthening to consolidate ownership of Aid for Trade, strengthen development partners' trade-related technical assistance and move forward integration into the global economy.

As a result, Cambodia's economy became more open and integrated, and trade policy was aligned with international trade rules and regulations. These determined strategies have laid a sound basis for further policy reforms and shored up public and private sector confidence in the government's management of the reform process.

2.1.2 Favourable Economic Conditions Achieved through Previous Reform

Cambodia has done exceptionally well to maintain macroeconomic stability. Inflation has been contained at below 5 percent, the KH riel vs. US dollar exchange rate kept stable, and fiscal credibility strengthened. The financial sector has made impressive progress in terms of healthy environment, greater innovation and competition.

Business and investment climate has improved significantly. The lead-time to export was reduced from 43 days in 2006 to 22 days in 2011 and the lead-time for import from 53 days to 26 days (World Bank 2013). With the introduction of the Automated System for Customs Data (ASYCUDA) system, over 90 percent of import declarations are cleared within 24 hours (from goods declaration to the release of goods) (WTO 2011). Further, a firm level survey in

Cambodia suggests improved perception of the investment climate, especially in aspects of legal reforms and access to finance and trade. Although a lot needs to be done to create an investment climate conducive to starting and running a business, the current environment provides the necessary conditions for higher levels of investment, trade and growth.

2.1.3 Active Players in Regional Cooperation Frameworks

Cambodia has been actively involved in the Greater Mekong Sub-region (GMS), the Ayeyawady-Chao Phraya-Mekong Economic Cooperation Strategy (ACMECS), the Association of Southeast Asian Nations (ASEAN) and several ASEAN-initiated schemes, including the ASEAN Free Trade Area (FTA), ASEAN-China FTA, ASEAN-Korea FTA, ASEAN-Japan FTA and broader ASEAN+3 initiatives. Regional cooperation initiatives benefit Cambodia in a number of ways.

First, the country is a beneficiary of GMS and ASEAN infrastructure and connectivity initiatives – major roads, railways, bridges, waterways and ports. Alongside these hard infrastructure improvements, there is further progress in soft infrastructure: regulatory reform of the government agencies and capacity building of the officials responsible for the smooth, transparent and cost-effective movement of goods and people across borders. This takes on greater importance with the increasing pace of GMS, ASEAN and East Asian connectivity and integration.

Second, through these trade arrangements, Cambodia's economy became more open, with significant improvements in economic conditions and the business environment. Under the ASEAN FTA, for example, Cambodia has committed to gradually reducing almost all tariffs on goods imported from ASEAN members to between zero percent and 5 percent by 2010. Under the ASEAN-China FTA, Cambodia has to eliminate all tariffs by 1 January 2015. As part of WTO accession, the government, with support from development partners, implemented regulatory and legal reforms in trade governance and strengthened trade facilitation (customs reform) and the institutional building framework in compliance with WTO rules and regulations. The review of Cambodia's trade policy conducted by the WTO highlights significant progress. A customs reform and modernisation programme was implemented aimed at creating a modern customs administration with fast, straightforward and reliable services. Major elements of the reform programme included strengthening the legal framework, restructuring tariffs, modernisation and streamlining of customs procedures, expansion of international relations, effective enforcement, automated systems and procedures, measures to strengthen the Customs and Excise Department and better services.

Third, membership in regional trade frameworks provides the country with experience in regional cooperation. Cambodia is learning by doing in international trade affairs and domestic reform processes. And, perhaps most importantly, it is establishing friendly cooperative foreign policy and projecting a positive country image in regional and global arenas.

2.1.4 Increased Level of Trade and Competitiveness

Since the mid-1990s, rapid revival in the trade sector has made it the key driver of economic growth. Total trade in 2011 reached USD12.16 billion, a big jump from USD3.33 billion in 2000 at average annual growth rate of 14 percent. Analysis of revealed comparative advantage (RCA) index indicates that Cambodia has a very strong competitive edge in labour-intensive manufacturing such as apparel (HS 61, 62, 63) and footwear (HS 64): exports of these products represent nearly two thirds of total exports. Despite the slowdown in demand for clothes and footwear in major export markets, production of these goods will continue to increase, at least in the near future, and their competitiveness should remain firm.

Cambodia has yet to become competitive in agricultural trade, with agricultural goods contributing just 4.9 percent of total exports; however, a positive trend is forecast. The RCA index suggests prospects for certain agricultural products. Those that had no comparative advantage four years ago appear to be more competitive now and increasingly contribute to total exports. Cereal is the most successful product, both in terms of a jump in export value and stronger competitiveness proven by significant gain in its RCA index from 0.4 points in 2007 to 4.4 points in 2011. Other major export products making impressive progress in comparative advantage are sugar and sugar confectionery, live animals, rubber, edible vegetables and roots.

2.2. Role of Trade in Past Growth Process

Despite absence of empirical evidence, it is hard to deny the important role trade policy has played in boosting growth. Cambodia has benefited from its liberalised trade and investment policy in a number of ways, including linking its economy more firmly to regional and global markets and increasing trade, investment and competitiveness. Most of the growth has been driven by four sectors: garments and footwear, tourism, construction and agriculture. The garment sector is the leading exporter, making up 12 percent of the 2010 GDP. Its exports went from almost zero in 1994 to USD4.54 billion in 2010, equivalent to 86 percent of the total. The boom in the garment sector is a clear example of how outward-looking trade policy affects growth. The tourism sector owes its rapid growth to key policies such as the Open Sky Policy introduced in late 1997 and regional policy cooperation, namely the GMS Tourism Strategy that aims to create a sub-regional tourism sector as a major engine for development, and the ASEAN Tourism Strategic Plan. Liberalisation of financial services, especially under the Global Agricultural Trade System (GATS) framework, has helped strengthen Cambodia’s financial system (Hing 2009). The outreach of the financial system has deepened and widened, and its competitiveness and efficiency have significantly improved. More than contributing directly to output and employment, a more robust and efficient financial system can provide essential infrastructure for the entire economy.

2.3. A Changing Trade Landscape

International trade governance has undergone significant changes. The world is more interconnected: multilateral trading underpinned by World Trade Organisation (WTO) rules remains a central pillar of the international trading system, regional trade arrangements (RTAs) have proliferated creating the “spaghetti bowl” syndrome, and global supply chains have become much more prevalent. Global experiences indicate that no country can sustain high growth without integrating into the world economy, and that should be the way forward for Cambodia’s trade and growth strategy.

The prospect of an integrated Asian production network and market from southern China through the GMS countries to the rest of Southeast Asia offers Cambodia a rich seam of investment and trade to spur private sector development and prosperity. The country has not been part of the intra-regional dynamics of production sharing, but a new shift in the phenomenon of Asia’s global supply chains promises to inspire a new era of opportunity for emerging economies. Because of rising costs, a considerable number of firms are moving production away from China and relocating in low-cost countries to exploit comparative advantages, namely low labour costs, increasing intra-regional dependence and third country market access. This trend is evident in the investment of two Japanese firms –Minebea, a global leader in micro-motors, and Sumitomo Electric, a leading producer of wiring harnesses – to set up state-of-the-art production facilities in Cambodia to serve global markets. Since global supply chains rely on open trading systems, trade and industrial policy will play a crucial role in determining the rate of off-shoring[3] in Cambodia.

3. Policy Priorities to for International Trade and Growth

3 Off-shoring is a type of outsourcing that involves the relocation of a company's business process or processes to a foreign country.

This paper takes the view that while trade is a necessary condition for growth, it is not sufficient. To sustain growth in the longer term, a whole set of different factors apart from export promotion policy needs to come together: effective government, macroeconomic stability, technology and knowledge transfer, and high level of investment in infrastructure, education and healthcare. Following are policy priorities to promote export and enhance diversification as key drivers to sustainable economic growth.

(i) ***Maintain sound macroeconomic management*:** Securing a stable and resilient macroeconomic environment will continue to be critical to underpinning successful outcomes from trade promotion policies. Policy priorities for sound macroeconomic management include containing inflation under 5 percent, maintaining exchange rate stability, building external sector resilience, improving revenue collection, and strengthening financial sector services. Financial regulatory reforms need to set in place pro-market financial institutions, pro-competition regulatory frameworks and macroeconomic and monetary stability prior to opening up financial sectors.

***(ii) Improve investment climate*:** This is an effective complementary strategy in fostering export performance and sustaining growth. A climate conducive to investment combines a number of factors, such as degree of macroeconomic certainty; quality and accessibility of infrastructure; extent of government regulations; nature of taxation; access to and cost of financing for firms; access to, cost, and quality of factors of production; degree to which the government levels the playing field for firms; governance and corruption; and security. Improving the investment climate is synonymous with removing or reducing these perceived constraints. Some of the policies to do this should be upgrading infrastructure, streamlining customs procedures, enhancing logistics and investing in human capital. While such improvements are already in the priority agenda of the government, also needed are: strong recognition of the issue by concerned institutions and stakeholders;

sufficient human and financial resources; political support to tackle sensitive issues; and a stronger and more harmonious public-private partnership.

***(iii) Simplify customs procedures*:** Customs formalities including paperwork, clearance, regulations and fees are among the top three impediments to exports (World Bank 2009; ADB 2012). Inefficient import and export processes directly affect trade costs, total factor productivity, and competitiveness. Cambodia requires comprehensive reforms to ease major constraints perceived by the private sector, in particular processing customs and trade documents, coordination among trade facilitation agencies, and access to information on export procedures, regulations and fees.

***(iv) Improve logistics efficiency*:** Cambodia is among the countries with the least efficient logistics services in the region. The World Bank's logistics performance index 2012 ranked the country at 101 among 155 countries. Poor logistics performance largely stems from a host of factors including insufficient and poor quality of infrastructure; low efficiency and effectiveness of the clearance process by customs and border control agencies, and low competence and quality of logistics services. Policy interventions can range from improved trade-related hardware infrastructure to better border management, i.e. through reforming and modernising customs and wider information sharing, greater competition in trucking, port and air freight services, and ready access to information about international transit agreements.

***(v) Strengthen regional cooperation and connectivity*:** Cambodia is at the heart of the GMS, ASEAN, ASEAN+3 and several other regional frameworks. The prospects of an integrated Asian production network and market and huge East Asian market for exports offer vast opportunities for trade growth, private sector development and prosperity. The country has not yet fully harnessed opportunities from regional integration; this is evident in low intra-regional trade and weak awareness and engagement in ASEAN and AEC processes by the private sector. The immediate challenge is to ensure that regional cooperation is reached and is taken advantage of by the trade sector so that exports can diversify from dependency on just a few sectors. In achieving that, Cambodia must deepen regional cooperation and partnerships to achieve longer term development objectives. Central to this will be ensuring the coordination and synchronisation of GMS-ASEAN-East Asian development cooperation and regional integration to include a focus on sustained growth and bridging the development gap, with associated regional investment in long-term institutional capacity development.

(vi) ***Deepen implementation of Special Economic Zones (SEZ)*****:** Introduced almost a decade ago, SEZs have not been as successful in attracting investors as initially hoped. Of the 21 approved SEZs, only eight are operational. Apart from superior infrastructure and fiscal incentives, SEZs must administer taxes and enforce regulations efficiently and to a high standard, overcome a range of bureaucratic and administrative hurdles, tailor solutions to smooth the problems investors face, create more flexible employment relationships, and ensure ready access to low- and high-skilled labour. Because the SEZ strategy involves comprehensive institutional and regulatory reforms, the zones' success requires strong leadership and political oversight from the government. That will include a commitment to streamline cumbersome and complicated regulatory processes, to manage the pervasive corruption, to ensure the efficient delivery of services and to provide regulatory oversight. Finally, the strategy needs to be accompanied by an effective investment promotion agency that actively seeks to attract FDI.

(vii) Invest in human capital**:** Cambodia's current labour market is characterised by the dominance of a low-educated workforce, skill mismatch and skill gaps. Learning from the experience of successful exporting countries, Cambodia must invest heavily in human capital development. Education policies should stress universal primary education and improvement in quality at primary and secondary levels. Tertiary education should focus on higher education in science and technology and technical and vocational education and training. Priority policy options include improving school infrastructure especially in rural areas, increasing the supply of technical and vocational schools to match demand for skilled labour, improving the quality of teaching and the governance of tertiary education, and institutionalising research and development capacities in higher education institutions.

***(viii) Improve export market information services*:** The private sector lacks knowledge of export procedures and export markets (WTO 2011). Given the role of trade promotion organisations in overcoming information asymmetries, strengthening the function of the Trade Promotion Department (TPD) as part of the export promotion strategy is sensible. A short-term priority measure should focus on providing support and information needed by exporting firms, particularly in the areas of product and market development and market information services. Development partners funding can be useful in the initial stages of reform as it can promote best practice and effective organisations. But such support should be temporary and followed by sufficient domestic resources, by either full government funding or a combination of government financing and service charges. Another important element in strengthening the TPD is ensuring quality staffing through on-going capacity building and recruitment of talented staff with business experience. Policy measures should also focus on building domestic trade networks (government, private sector, and investor) and overseas networks (foreign governments, international buyers and investors), and improving information systems.

***(ix) Improve standards compliance*:** Cambodia has encountered great challenges in complying with importing countries' technical standards. Monitoring and enforcement of standards compliance suffers from serious flaws including weak legal and regulatory frameworks, poor coordination and duplication of functions among various agencies, absence of systematic laboratory testing to support inspection due to limited human and financial resources, lack of systematic inspection and monitoring, and a certification system that is not backed by testing (FAO 2010). Comprehensive reforms are needed to resolve all major problems in the standards management system. Pragmatic measures should focus on strengthening institutional frameworks especially in relation to mandates and coordination, building technical and managerial capacity, and establishing Cambodia Assessment Bodies (CABs) that are recognised by international accreditation agencies.

4. Conclusion

Cambodia's experience in developing its trade is impressive. The country not only managed its economic transition successfully but also transformed trade into a driving force of economic growth through liberalising trade and investment and opening up to regional and global cooperation. Now, trade has reached a level that needs to sharpen competitiveness and move up value chains. The challenge is how to leverage trade for economic growth in the changing domestic and international economic environment. Cambodia's trade sector remains constrained by regulatory, institutional and infrastructure and service bottlenecks. The key to enhancing the role of trade in the country's growth is to remove these obstacles. Policy priorities include investing in trade-related infrastructure, improving logistics efficiency, improving customs procedures, strengthening regional cooperation and connectivity, improving export market information services and improving standard management systems. These measures should come together with a number of complementary policies including macroeconomic stability and financial sector development, improvements in the investment and business climate, investment in general infrastructure, education and health and technology and knowledge transfer. There will also be a need to strengthen sub-regional and regional economic integration as a complement to the global trading system and to exploit the benefits of economic cooperation. Experience also suggests that trade policy is most likely to be associated with positive outcomes when it is conducted with effective institutions and strong commitment from the leadership. Therefore trade policy liberalisation and reforms need to gain political support from the leadership, receive momentum and impetus from stakeholders and be supported by effective and responsive institutions.

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