

Executive Summary

Cambodia and the Eurasian Economic Union (EAEU) are seeking a free trade agreement between them to increase trade, investment, and economic collaboration. The proposal to undertake a feasibility and impact study on Cambodia of the Cambodia-EAEU FTA is a request by the Ministry of Commerce, the Ministry of Economy and Finance, and the Royal Government of Cambodia.

Cambodia has been exploring a free trade agreement (FTA) with the EAEU to expand market access to Eastern Europe. The EAEU is a common market comprised of five nations (Armenia, Belarus, Kazakhstan, Kyrgyzstan, and Russia), 176 million people, and a gross domestic product of US\$2.5 trillion. The study examines the key impacts of a Cambodia-EAEU FTA on the Cambodian economy and the ASEAN region in terms of trade, investment, welfare, and the growth impact on the domestic and regional economy.

The FTA between Cambodia and the EAEU is widely expected to create significant opportunities for trade and investment. Cambodia could further boost the export of textiles and garment and agricultural products, while Eurasian exporters could potentially gain greater access to growing markets, especially in energy.

This study aims to quantitatively and qualitatively assess the impacts of this proposed FTA. It will also examine the current FTAs of the EAEU and provide updates on the Singapore-EAEU FTA negotiations and the Viet Nam-EAEU FTA.

The study also documents the trade and investment-related issues of border and behind-the-border issues affecting trade and foreign investment between Cambodia and the EAEU. It identifies key sectors that will be affected by CEFTA, focusing in particular on (i) energy, (ii) manufacturing (garment and textiles), (iii) agriculture, (iv) tourism, (v) aviation, (vi) telecommunications, and (viii) logistics.

The study identifies key policy challenges and recommendations to inform policymakers and help them maximise the benefits from the FTA negotiations.

Key Results

- 1) CEFTA appears to be a win-win opportunity for Cambodia to deepen its economic integration with the global production value chain and increase its integration with Central Asia and Russia.
- 2) Regional FTAs provide the potential to induce key structural changes in the economy for a wider economic reform agenda as opposed to a narrow domestic agenda. The structural reforms could be undertaken in a structured framework (sequence of sectoral and key reforms) to manage the structural shifts and structural costs (for example, unemployment) in the domestic economy. CEFTA is expected to create potential dynamic gains (allocative efficiency) for Cambodia in terms of integrating

with the global economy and allow it to implement key structural reforms in the domestic economy in a structured framework.

- 3) The simulations of the recent FTA between the EAEU and Viet Nam alone show some negative impacts on Cambodia's economy, mainly due to competition in key export products (garments). The negative impact will be on Cambodia's GDP through trade diversion (imports become more expensive, raising production cost, reducing household demand and investment). Thus, CEFTA would not only offset the potential negative impacts but also create positive gains in terms of market access in existing products and could result in new investment in Cambodia.
- 4) Trade (Global Trade Analysis Project [GTAP]) simulations show greater potential dynamic output gains for Cambodia if CEFTA leads to deeper and more structural and economic liberalisation. Deeper economic and trade liberalisation and structural reforms that improve productivity could generate an average growth of around 2.4% from CEFTA compared with a less ambitious FTA based on the same conditions as the Viet Nam–EAEU–FTA which would be likely to generate growth of only 0.24%.
- 5) There are potential investment and trade impacts due to diversifying the manufacturing sector to higher value-added garment activities, shifting the industrial base to more value-added activities in light machineries and parts and components to complement Viet Nam (through the Viet Nam–EAEU FTA's trade and investment provisions for Russian investment for vehicle parts and components in Viet Nam) and Thailand. Furthermore, there are potential gains in investment opportunities and for productivity improvements in the services sector and to develop the key service sectors in tourism, aviation, agriculture services, and educational services in the global production value chain framework. And there is a potential to develop agriculture services and exports that have not been fully exploited in the economic development of Cambodia's economy.
- 6) Trade simulations indicate that joining the EAEU would benefit most of Cambodia's manufacturing sectors, including garment and textiles. The links to Belarus and Russia provide strong opportunities to level up and diversify the garments industry up the global value chain (GVC) activities. There are also opportunities to level up the manufacturing to light and part and components such as chemical and rubber, iron and steel, fabricated metals, machinery, and other transport equipment (which are part of the recommendations of the Industrial Development Plan [IDP]). There is a need to reduce the tariffs on textiles, other transport equipment, chemical and rubber products, and fabricated manufacturing from the EAEU, which are important sectors for Cambodia in terms of moving up the GVC.
- 7) The simulation results indicate that Cambodia will see a negative impact on the electronics sector (the trade creation and positive impact is stronger for Viet Nam). There is a need, therefore, to explore the possibilities of creating agglomerative effects and spillovers in Thailand's special economic zones at the border to create complementarities in Thailand's border activities.

- 8) Cambodia can further boost the export of textiles and garment, and agricultural products, while Eurasian exporters would potentially gain greater access to growing markets both in Cambodia and ASEAN at as a whole.
- 9) There is potential to create new markets for agricultural products and exports to Belarus and Russia. This has to be developed together with improvements in the quality of Cambodia's agricultural products and in standards and branding, marketing, logistics, and warehousing services. There is also potential to develop new markets in green products and green exports.
- 10) The key dimension of CEFTA is the potential to induce and develop agricultural export products, but this must be complemented with creating infrastructure and linkages to key export markets for agricultural activities.
- 11) The trade simulations also indicate a negative impact on processed rice production, mainly due to the competitiveness of Viet Nam as markets are liberalised in both Cambodia and Viet Nam due to the FTA with the EAEU.
- 12) There is also potential to create markets for energy, gas, and petroleum, in which Russia seems to have superior technology and greater global market participation. The potential for Russia to invest in the energy and gas market in Cambodia will have an important impact on the energy sector and competitiveness in the domestic market.
- 13) The development of the energy market could be complemented with the development of green and environmentally conducive industrial activities that will have an important welfare and social impact on Cambodia.
- 14) The development of service sectors and the potential to develop trade in services will be the most likely gains of CEFTA. Trade-enabling services such as transport, insurance, banking, telecommunications, distribution services, computer and related services, other business and professional services, tourism, engineering services, environmental and agricultural services, energy, educational services, etc. could potentially develop and grow with CEFTA.
- 15) There are likely to be two types of services development from CEFTA:
 - a. Service sectors linked to the growth of manufactured goods and exports
 - b. Service sectors independent from the growth of manufactured goods and exports
- 16) The services chapter is likely to be driven by mutual trade in services from possible reduction in market access, national treatment impediments, dispute settlement issues in services investment, and in improving transparency and predictability in measuring services trade.
- 17) The development of the service sectors and trade will have important implications for Cambodia in increasing the services linkages and lowering trade transaction cost. This will greatly impact innovative activities in services and thereby increase productivity.

- 18) The key service sectors likely to be developed are: (i) agriculture, (ii) tourism, (iii) financial services, (iv) creative industries (driven by Belarus and Russia), (v) digital economy (driven by Belarus and Russia), (vi) e-commerce, (vii) logistics, (viii) aviation, (ix) energy-related services, (x) telecommunication and space services, and (xi) business services.
- 19) The development of the services sector must be addressed with deregulation and greater exposure of the domestic market to regional and global competition. Services liberalisation should focus on domestic deregulations, the mutual recognition agreements, and the different modes of service delivery including mode 4 (movement of people) in recognition of professional services which are expected to enhance trade in services.
- 20) Investment liberalisation should focus on national treatment impediments and enhance the transparency and predictability of measures affecting investment and investors.
- 21) The potential areas for investment from the EAEU in Cambodia include: (i) processed food, (ii) heavy engineering goods, (iii) transportation goods, (iv) minerals and metallurgy, (v) tourism services, (vi) research and development centres, (vii) space technology, (viii) energy-efficient technology, (ix) green industry and products, (x) e-commerce, and (xi) digital trade.
- 22) Several trade-related issues need to be considered: (i) intellectual property rights, (ii) competition policy, (iii) government procurement, (iv) environment policy, (v) labour standards, (vi) trade facilitation, and (vii) e-commerce.