

Chapter 10

Policy Recommendations

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CEFTA appears to be a win-win opportunity for Cambodia to deepen its economic integration in the global production value chain and to integrate with Central Asia and Russia. The key elements of CEFTA is to create market access and new markets and to undertake structural reforms to shift the industries to higher value-added activities. The simulations indicate that the FTAs that are more progressive and undertake deep structural reforms tend to gain most from trade liberalisation and regional FTAs. These gains are reflected in productivity gains from allocative efficiencies, identifying new markets for agriculture and service sectors, SME development and structural reforms in the economy to higher value-added activities.

CEFTA is expected to create significant opportunities for trade and investment. Cambodia could further boost the export of textiles and garment, agricultural products, while Eurasian exporters could potentially gain greater access to growing markets in both Cambodia and ASEAN at large.

The potential long-term gain would be realised through attraction of better investment (trade–investment linkages) to all member countries in addition to gains from trade efficiency and reallocation of resources (investment and consumption). The biggest gains for all member countries would be realised if the FTA covers the services sector, which could lead to improved productivity in the sector (domestic reforms).

1. Key Results

- 1) Regional FTAs could potentially induce key structural changes in the economy for a wider economic reform agenda as opposed to narrow domestic agenda. There are potential gains in allocative efficiency in terms of structural reforms and creating new markets from the FTA. 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 could create potential dynamic gains for Cambodia through integration into the global economy and implementation of key structural reforms in the domestic economy in a structured framework.
- 2) The simulations of the recent FTA between the EAEU and Viet Nam alone would negatively impact Cambodia's economy mainly because of competition in key export products (garments). The negative impact will be on Cambodia's GDP through trade diversion (imports become more expensive, raising production costs and 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 of existing products and potential investment into Cambodia.
- 3) Trade (GTAP) simulations show greater potential dynamic output gains (allocative efficiency) for Cambodia if deeper and more structural and economic liberalisation is aligned with CEFTA. Deeper economic and trade liberalisation and structural reforms that improve productivity could generate an average growth of around 2.4% from CEFTA compared to a low-based FTA with the same conditions as the EAEU–VN FTA, which will likely generate a growth of 0.24%.

- 4) Potential investment and trade impacts are as follows: (i) 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 Nam²³ and Thailand; (ii) potential gains in investment opportunities and improving productivity in the services sector and to develop the key services sectors in tourism, aviation, agriculture, and education in the global production value-chain framework; and (iii) potential to develop agriculture services and exports that have not been fully exploited in developing the Cambodian economy.
- 5) Trade simulations indicate that joining the EAEU would benefit majority of Cambodia's manufacturing sector, including garment and textiles. The links to Belarus and Russia provide strong opportunities to level up and diversify the garments industry up to the global value chain activities. There are also opportunities to level up the manufacturing to light and parts and components such as chemical and rubber, iron and steel, fabricated metals, machinery, and other transport equipment (which are part of the IDP recommendations). 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 to move up the global value chain.
- 6) The simulation results indicate that Cambodia will experience a declining impact in the electronics sector (trade creation and positive impact is stronger for Viet Nam). Thus, exploring the possibilities of creating agglomerative effects and spillovers in the border special economic zones in Thailand is needed to create complementarities at the border activities of Thailand and Viet Nam.
- 7) Cambodia could further boost the export of textiles and garments, and agricultural products while Eurasian exporters could gain greater access to growing markets in Cambodia and ASEAN at large.
- 8) The agriculture sector in Cambodia has not achieved its potential in production, investment, and trade.
 - a) CEFTA provides opportunities to create new markets for the agriculture sector in both production and in developing the services sector in agriculture. There is potential in creating new markets for agricultural products and exports to Belarus and Russia. This must be developed with improvements in the quality of Cambodian agricultural products and development of agricultural services in terms of standards and branding, marketing, logistics, and warehousing. There is also potential in developing new markets in green products and green exports.
 - b) The key dimension of CEFTA is the potential to induce and develop agricultural export products. But this must be complemented by creating infrastructure and linkages to key export markets for agricultural activities.
 - c) The trade simulations also indicate negative impact in processed rice production. This is mainly due to the competitiveness of Viet Nam as markets are liberalised in both Cambodia and Viet Nam from the EAEU FTA.

²³ The EAEU–VN FTA has trade and investment provisions for Russian investment for vehicle parts and components in Viet Nam.

- 9) There is also potential to create markets for energy, gas, and petroleum, for which Russia seems to have technology and greater global market participation. The potential for Russia to invest in the energy and gas market in Cambodia will impact the energy sector and competitiveness in the domestic market.
- 10) The development of the energy market could be complemented with the development of green and environmental conducive industrial activities that will have important welfare and social impact to the Cambodia.
- 11) The development of the services sector and potential to develop trade in services will be the likely gains of CEFTA.
 - a) Two types of services will likely develop from CEFTA:
 - i. Services sector linked to the growth of manufactured goods and exports
 - ii. Services sector independent from the growth of manufactured goods and exports
 - b) Trade-enabling services – such as transport, insurance, banking, telecom, distribution services, computer and related services, other business and professional services, tourism, engineering services, environmental and agricultural services, energy, educational services, etc. – can potentially develop and grow with CEFTA.
 - c) The services chapter will likely 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.
 - d) The development of the services sector and trade will have important implications for Cambodia in increasing services linkages and lowering trade transaction costs. This will impact on innovative activities in services, thereby increasing the productivity of services.
 - e) The key services sector that will likely develop are (i) agriculture services, (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.
 - f) Services sector development must be addressed with deregulation and greater exposure of the domestic market to regional and global competition. Services liberalisation should focus on domestic deregulation, the mutual recognition agreements, and different modes of service delivery including Mode 4 (movement of people) in recognition of the professional services expected to enhance trade in services.
 - g) The development of the services sector also increases the opportunity to develop the SMEs as most of them belong to the services sector. SME development in the services sector could be aligned with regional and global SME policies in terms of international SMEs and other key factors that lead to the growth of SMEs, such as human capital development and SME finance.

12) Investment liberalisation should focus on national treatment impediments and should enhance the transparency and predictability of measures affecting investment and investors.

- a) The potential areas for investment from the EAEU in Cambodia are (1) processed food, (2) heavy engineering goods, (3) transportation goods, (4) minerals and metallurgy, (5) tourism services, (6) research and development centres, (7) space technology, (8) energy-efficient technology, (9) green industry and products, (10) e-commerce, and (11) digital trade.

13) Several trade-related issues should be considered: (i) intellectual property rights (IPR), (ii) competition policy, (iii) government procurement, (iv) environment policy, (v) labour standards, (vi) trade facilitation, and (vii) e-commerce.