



The Early Harvest Programme: Implications for Cambodian Agriculture

Hing Vutha
and
Nou Keosothea

Phnom Penh, May 2006



Cambodia
Development Resource
Institute

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Abstract

This study examines the development, features and implications of the ASEAN-China free trade area (FTA) on regional economies. It particularly focuses on the economic benefits of the ASEAN-China FTA from the perspective of Cambodia, the potential impacts of the Early Harvest Programme (EHP) on its agricultural sector and recommended policy responses for Cambodia to derive the greatest benefits from the EHP. The analysis is primarily based on in-depth consultation with stakeholders, and secondary data analysis of current trade patterns between China and Cambodia, with some references to trade between China and Thailand and Vietnam.

The study found that the ASEAN-China FTA provides advantages and economic benefits to all member countries in terms of increased trade, economic efficiency, investment and strengthened cooperation. The removal of trade barriers between ASEAN and China may lower costs, increase intra-regional trade, increase economic efficiency and improve investment prospects in the region. The EHP, which is a provision of the Framework Agreement aimed at accelerating liberalisation of trade in most agricultural products, could provide Cambodia an opportunity to develop its agriculture as a source of growth and poverty reduction. The EHP offers promising prospects for developing agriculture through exporting products such as fresh fruits, livestock, fish, shrimps and prawns to the dynamic Chinese market. However, these benefits have not materialised yet because Cambodia has not fully met the prerequisites of a sound business climate, adequate legal framework, provision of basic infrastructure and effective public institutions. As a result, the competitiveness of Cambodia's agriculture and enterprises continues to be relatively low.

Addressing all major constraints on agricultural development and supply-side capacity is strongly recommended if Cambodia is to derive the greatest benefits from the EHP. Administrative, legal and judicial reforms, provision of sufficient basic infrastructure and enabling policy and a regulatory framework are certainly priority issues that government should address. In addition, improving agricultural productivity, enhancing the productive capacity of enterprises, reducing the cost of conducting trade and strengthening cooperation between Cambodian and Chinese business associations are also vital to promoting Cambodia's agricultural trade.

For the EHP to have a greater impact on poverty reduction, government support and policy responses should promote the involvement of the poor in trade liberalisation and growth. There should also be appropriate adjustment measures to mitigate potential negative impacts on the poor. The future of agriculture and the contribution of the EHP to poverty reduction in Cambodia depend on the success of the government's policy and reform programmes to enhance agricultural and enterprise competitiveness.

Acronyms and Abbreviations

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
CEPT	Common effective preferential tariff
EHP	Early Harvest Programme
FDI	Foreign direct investment
FTA	Free trade area
GDP	Gross domestic product
GEL	General exception list
GMS	Greater Mekong Sub-region
HS	Harmonised System
IL	Inclusion list
MFN	Most favoured nation
SADZ	Special agricultural development zone
SL	Sensitive list
SME	Small and medium enterprises
TEL	Temporary exclusion list
WTO	World Trade Organisation

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Chapter One:

Introduction

1.1. Background

Relations between the Association of South-East Asian Nations (ASEAN) and the People's Republic of China have been formalised since 1994, when China became a participant in the ASEAN Regional Forum and then a dialogue partner of ASEAN in 1996. ASEAN-China relations started to pick up pace with the establishment of the ASEAN-China Joint Cooperation Committee, the ASEAN-China Cooperation Fund and a series of ASEAN-China summits. Cooperation between ASEAN and China in trade, investment, science and technology, security, agriculture and human resource development has been strengthening rapidly. For example, trade grew from US\$11.06 billion in 1994 to \$39.5 billion in 2000. In 1991, ASEAN's investment in China was only \$90 million. It reached \$4.8 billion in 1998 and \$26.2 billion in 2001. China's investment in ASEAN reached \$1.1 billion in 2001.

Given such rapid developments and the increasing number of regional trade agreements around the world, a free trade area between ASEAN and China was proposed in the ASEAN Plus Three summit in November 2000. The Framework Agreement on Comprehensive Economic Cooperation between the ASEAN countries and China was signed at the eighth ASEAN summit in November 2002 in Phnom Penh, aiming to further strengthen trade and investment cooperation and to form a free trade area within 10 years. The ASEAN-China FTA will create a market of 1.7 billion customers with a regional gross domestic product of about \$2,000 billion and total trade estimated at \$1,230 billion (ASEAN-China Expert Group, 2001). It will be the largest FTA in the world in terms of population and also the largest made up of developing countries in terms of GDP and trade.

According to economic theory, free trade areas offer potential advantages to all members, ranging from greater economic efficiency to closer cooperation and partnership in non-economic areas such as peace and stability. The removal of trade barriers may lower costs, increase intra-regional trade and increase economic efficiency. According to the simulation conducted by ASEAN-China Expert Group (2001) suggest that the ASEAN-China FTA could increase ASEAN exports to China as much as by \$13 billion, or 48 percent and China's exports to ASEAN by \$10.6 billion, or 55.1 percent. Furthermore, the ASEAN-China FTA is also likely to improve investment prospects in the region. Not only might more ASEAN and Chinese companies be willing to invest within the integrated market, but US, European and Japanese companies interested in making inroads into the Asian market may also be attracted. In the long run, with a larger market, more intense competition, increased investment and economies of scale, investors may be more inclined to locate in the integrated region.

Cambodia, which has made significant progress integrating into the regional and global economies through memberships in ASEAN, the Greater Mekong Sub-region (GMS) and the WTO, perceives the Framework Agreement as an important mechanism for promoting trade and investment and stimulating economic growth and development. The Framework Agreement is likely to create both economic and non-economic opportunities for Cambodia. The economic benefits include promoting trade, investment, economic efficiency and welfare. Non-economic opportunities might include strengthening relations and cooperation in areas such as tourism, human resource development and security, and closer cooperation between China and Cambodia in the GMS.

The Early Harvest Programme is a provision in the Framework Agreement that aims to accelerate implementation of the agricultural components of the agreement. It covers eight groups of agricultural produce—live animals, meat and edible meat offal, fish, dairy produce, other animal products, live trees, vegetables and fruits and nuts—and sets a three-year time frame from January 2004 for implementation. It provides special and preferential treatment and more flexibility to the new ASEAN countries (Cambodia, Laos, Myanmar and Vietnam) by allowing until 2010 for tariff reduction and elimination.

The EHP is an opportunity for Cambodia to develop agriculture as a new source of economic growth and poverty reduction through promotion of agricultural exports. Although Cambodia-China trade in EHP products is not at this time significant, accounting for only 0.33 percent of total trade during 2000–05, access to the huge and dynamic Chinese market would provide Cambodia with greater potential to export agricultural products. Live fish was Cambodia's largest export item during 2000–05, valued at \$3.99 million, followed by shrimps and prawns, live animals and mushrooms and truffles. During the same period, garlic was the largest agricultural import from China, followed by apples, mushrooms and truffles, pears and quinces, red beans, honey and fish. The structure of trade between Cambodia and China and the experiences of other countries indicate that the EHP presents promising opportunities for Cambodia to export agricultural products to China. These include current export items like fish, shrimps and prawns, and potential exports such as cassava, cashew nuts and fresh fruits like durian, pineapples, longans and bananas. Because Cambodia's competitiveness in these products is much lower than that of Vietnam and Thailand, Cambodia should target a niche market for its agricultural commodities based on a unique taste.

On the other hand, the EHP also causes some concerns for Cambodia, especially the possibility of imports from China crowding out domestic producers. However, because Cambodia-China agricultural trade structure is highly complementary between Cambodia's tropical products and China's temperate products, the potential negative impacts of the EHP on Cambodia may not be very significant. The agricultural sector in Cambodia is not likely to be significantly negatively affected by the EHP, at least in the short and medium terms.

Until now, there has been little study of the economic benefits and costs of the EHP for Cambodian agriculture and the corresponding policy responses. This study attempts to fill this gap by addressing the following important questions: What are the implications of the Framework Agreement and the Early Harvest Programme for Cambodia and its agricultural sector? What can government policy makers and planners do now and in the future to derive the greatest benefits from the EHP and to mitigate its potential negative impacts?

1.2. Research Objectives

The study has two overall objectives: (1) to raise awareness, knowledge and understanding of bilateral and regional trade agreements, of which the EHP is one aspect, and (2) to understand the potential impacts of the EHP on Cambodia in general and on Cambodian agriculture in particular.

Its four specific objectives are: (1) to analyse the salient features of the EHP and to identify the opportunities and challenges for the region and Cambodia in relation to it; (2) to assess the potential impacts of the EHP on agricultural exports and imports and on domestic producers; (3) to identify feasible policy responses to the EHP in terms of promoting agricultural exports and building supply-side capacity, as well as making the EHP a poverty reduction tool; and (4) to identify areas for further research.

1.3. Research Methodology

The study utilised two different research methods: desk research and key informant interviews.

Desk research: Literature on the Framework Agreement and the EHP was reviewed. Secondary data were considered, especially the structure of trade between Cambodia and China, and the structure of trade between Thailand, Vietnam and China, to assess potential impacts on trade in agriculture and the agricultural sector. Policy documents, especially those concerning business, the investment environment and impediments to agriculture and business growth in Cambodia, were reviewed. From this review, policy recommendations were developed to raise agricultural and enterprise competitiveness.

Key informant interviews: Several key informants representing import and export companies were interviewed for their perceptions and understanding of the Framework Agreement. The interviews sought feedback on policy dissemination, business support services and implementation by government. In addition, in-depth interviews with senior officials from the Ministry of Commerce and the Ministry of Agriculture, Forestry and Fisheries were conducted. These aimed at understanding perceptions of the Framework Agreement and the EHP from policy makers' perspective and seeing how liberalisation schedules are implemented.

1.4. Structure

This paper is structured as follows. Chapter Two describes the salient features of the Framework Agreement with particular focus on the EHP. The rationales, opportunities and challenges of the ASEAN-China FTA are also elaborated. Chapter Three discusses the implications of ASEAN-China FTA for Cambodia with particular emphasis on potential impacts of the EHP on its agricultural sector. It gives an overview of economic relationships between Cambodia and China, and reviews opportunities and challenges of the ASEAN-China FTA for Cambodia. The potential impacts of the EHP on agriculture are also assessed, focusing on export opportunities, challenges and poverty implications. Chapter Four looks at global, regional and bilateral trade agreements that Cambodia has concluded. Chapter Five discusses constraints on agriculture and major impediments to business operation and growth that prevent Cambodia, especially the agricultural sector, from fully benefiting from various trade agreements. It then suggests policy responses and recommendations for Cambodia to address constraints on agricultural development, and to build the capacity of Cambodian enterprises. Chapter Six provides concluding remarks.

Chapter Two: ASEAN-China Free Trade Area: Rationale, Economic Benefits and Features

This chapter looks at the ASEAN-China FTA in the context of its motivations, potential economic benefits and features. It starts by discussing the motivations and rationales for establishing the ASEAN-China FTA from both ASEAN and Chinese perspectives, and the economic benefits for both sides. It then discusses the salient features of the Framework Agreement with a focus on the EHP regarding product coverage, the modalities for tariff reduction and elimination and implementation time.

2.1. Rationales for ASEAN-China FTA

The motivations of ASEAN and China in forming the FTA are both economic and political. The ASEAN countries welcomed the idea of an FTA with China for a number of reasons. First, China is a huge and dynamic economy, and its growing demand for goods and services from ASEAN could serve as a new engine of growth (Chia, 2004). ASEAN looks at China as its future primary export market for energy raw materials and electronic and machine parts. Closer ASEAN-China economic ties will also enable ASEAN to reduce dependence on the US, EU and Japan (Bernardino, 2004). Second, China is quite flexible toward newer ASEAN countries, providing special and preferential treatment and development assistance, and extending WTO most favoured nation (MFN) benefits to the non-WTO members. Such measures make it feasible for the newer ASEAN countries to benefit from liberalisation by China and make it easier to bridge the development gap in the region. Third, China and ASEAN will be able to go further than the agreements and commitments made by all WTO members in liberalising agricultural trade, because China's temperate agriculture and ASEAN's tropical agriculture are complementary. Fourth, ASEAN views the ASEAN-China FTA as a potential route to speed up its post-crisis recovery. According to Bernardino (2004), ASEAN's wish is to "ride the Chinese economic express with the objective of attracting foreign direct investment (FDI) and hopefully redirect into the South East Asian region some of the huge amounts of FDI currently flowing into China".

China's motivations for forming the ASEAN-China FTA are both political and economic. Politically, China wishes to remain on friendly terms with its neighbours to the south (Chia, 2004). The ASEAN-China FTA is part of a confidence-building process to allay ASEAN concerns over China's economic threats by offering closer collaboration in areas including trade and investment, agriculture, information and communications technology, human resource development, Mekong basin development, tourism and security. Another main objective for China is geopolitical: countering the United States' containment strategy against China and protecting its trade routes in south-east Asia. Closer economic relations with ASEAN will enable China to build its geopolitical clout and counterbalance the influence of the US and Japan (Bernardino, 2004). Economically, China wants to make ASEAN its backyard and source of raw materials as it becomes an industrial economy and net agricultural importer (Bernardino, 2004). Bernardino also asserts that China's accession to the WTO in November 2001 and continued pressure by the US are behind China's drive to forge alliances with other developing countries, especially with its east Asian neighbours, including ASEAN, Japan and Korea, through ASEAN Plus Three initiatives and the ASEAN-China FTA.

2.2. Economic Benefits and Challenges of the ASEAN-China FTA

The ASEAN-China FTA will offer potential advantages to all members, ranging from greater economic efficiency to closer cooperation and partnership in non-economic areas. The removal of trade barriers between ASEAN and China may lower costs, increase intra-regional trade and increase economic efficiency. The FTA is also expected to lead to greater specialisation in production based on comparative advantage. The simulations conducted by the ASEAN-China Expert Group on Economic Cooperation suggest that an ASEAN-China FTA could increase ASEAN exports to China as much as by \$13 billion, or 48 percent, and China's exports to ASEAN by \$10.6 billion, or 55.1 percent. Among the ASEAN countries, the biggest gainers in exports are Indonesia, Malaysia, Singapore and Thailand. The FTA will also increase ASEAN's GDP by 0.9 percent or \$5.4 billion, while China's real GDP expands by 0.3 percent or \$2.2 billion. The tariff reduction schedule under the EHP indicates a significant increase in ASEAN-China trade. By July 2004, the value of EHP products traded between ASEAN and China reached \$1.11 billion, 42.3 percent higher than a year earlier; ASEAN exports to China were \$0.68 billion, a 49.8 percent increase over last year (Cordenillo, 2005).

The Expert Group and Bernardino (2004) share the view that the FTA is also likely to improve investment prospects in the region. Not only might more ASEAN and Chinese companies be willing to invest within the integrated market, but US, European and Japanese companies interested in making inroads into the Asian market may also be attracted (ASEAN-China Expert Group, 2001). Bernardino (2004) argues that FDI flow has gradually declined since the Asian financial crisis in 1997; this FTA could help transform ASEAN into a magnet for investment. For example, the FDI flow into ASEAN increased significantly after the Framework Agreement was concluded: from \$13.8 billion in 2002 to \$25.6 billion in 2004. In the long run, with a larger market, more intense competition, increased investment and economies of scale, investors will be more inclined to locate in the integrated region.

On the other hand, the FTA may also create challenges for both ASEAN and China. According to the ASEAN-China Expert Group (2001), the similarity in industrial structures between ASEAN countries and China means that the reduction and elimination of tariff and non-tariff barriers would cause intensified competition in the domestic markets of both sides. As a result, some industries might expand and others might contract. The latter may entail short-run costs in the form of displacement of workers and rationalisation of some industries and firms. Furthermore, the reduction of tariffs may also cause the loss of tariff revenues and thus might create difficulty in fiscal policy, especially for those countries that rely heavily on tariff revenues.

2.3. Features of the Framework Agreement

The Framework Agreement covers trade in goods and services and investment, with provision for the EHP to accelerate agricultural trade liberalisation, and for special and preferential treatment for newer ASEAN countries.

The objectives of this agreement are to: (1) strengthen and enhance economic, trade and investment cooperation; (2) progressively liberalise and promote trade in goods and services and create a transparent, liberal and facilitative investment regime; (3) explore new areas and develop appropriate measures for closer economic cooperation; and (4) facilitate the more effective economic integration of the newer ASEAN members and bridge the development gap among the parties.

To strengthen economic cooperation, the Framework Agreement specifies measures that ASEAN and China should take, which include:

- progressive elimination of tariffs and non-tariff barriers in substantially all trade in goods;
- progressive liberalisation of trade in services;

- establishment of an open and competitive investment regime;
- provision of special and preferential treatment and flexibility to the newer ASEAN countries;
- provision of flexibility to address sensitive areas in goods, services and investment in the FTA negotiations;
- establishment of effective trade and investment facilitation measures, such as simplification of customs procedures and development of mutual recognition arrangements;
- expansion of economic cooperation in areas that complement the promotion of trade and investment;
- establishment of action plans and programmes to implement the agreed areas of cooperation and appropriate mechanisms to implement the agreement.

2.3.1. Trade in Goods

ASEAN and China have agreed to negotiate tariff reductions for substantially all goods not covered in the EHP. The negotiations on liberalisation of trade in goods—which include the modality of tariff reduction or elimination, rules of origin, non-tariff measures, safeguards based on GATT principles, disciplines on subsidies and countervailing measures and anti-dumping measures—began in early 2003. The agreement on trade in goods of the Framework Agreement was signed at the 10th ASEAN summit, in November 2004. The tariff lines subject to reduction or elimination include all those not covered by the EHP. They are categorised for tariff reduction and elimination as follows:

- *Normal Track*: Products listed in the normal track are to have their applied MFN tariff rates gradually reduced or eliminated in accordance with specified schedules and rates over the period from 1 January 2005 to 2010 for the ASEAN 6 and China and from 1 January 2005 to 2015 for newer ASEAN members.¹ Those tariffs that have been reduced but not eliminated are to be progressively eliminated within a time to be mutually agreed.
- *Sensitive Track*: Products listed in the sensitive track are to have their applied MFN rates reduced to end rates and dates to be mutually agreed. The number of products in this track is subject to a ceiling of 400 tariff lines at the Harmonised System (HS) 6-digit level and 10 percent of total import value² for the ASEAN 6 and China, and of 500 tariff lines for the newer ASEAN countries.

2.3.2. Trade in Services

ASEAN and China also agreed to negotiate progressive liberalisation of trade in services with wider coverage. Negotiations on trade in services began in 2003 and are to be concluded as quickly as possible. They are directed at the progressive elimination of substantially all discrimination, expansion in the depth and scope of liberalisation of trade in services and further cooperation in services to improve efficiency and competitiveness as well as to diversify the supply and distribution of services.

1. For detailed information on specified rates and data, see annex 1 of the Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China at <http://www.aseansec.org>.

2. Based on 2001 trade figures.

2.3.3. Investment

To promote investment and create a liberal, facilitative, transparent and competitive investment regime, the parties agreed to: (1) negotiate to liberalise progressively the investment regime; (2) strengthen cooperation in investment, facilitate investment and improve transparency of investment rules and regulations; and (3) provide for the protection of investments.

ASEAN and China have also agreed to strengthen cooperation in five priority sectors: agriculture, information and communications technology, human resource development, investment and Mekong basin development. There will be capacity-building programmes and technical assistance, particularly for the newer ASEAN countries, in order for them to adjust their economic structures and expand trade and investment with China.

2.3.4. EHP

The EHP is included in the Framework Agreement to accelerate tariff reduction and elimination on traded goods in chapters 1–8 at the HS 8/9 digit level, which includes:

1. live animals;
2. meat and edible meat offal;
3. fish;
4. dairy produce;
5. other animal products;
6. live trees;
7. edible vegetables;
8. edible fruits and nuts.

All products covered under the EHP are divided into three categories for tariff reduction and elimination:

- *Category 1:* For the ASEAN 6 and China, this refers to all products with applied MFN tariff rates higher than 15 percent. For the newer ASEAN countries, it refers to all products with applied MFN tariff rates of 30 percent or higher.
- *Category 2:* For the ASEAN 6 and China, this refers to all products with applied MFN tariff rates between 5 percent and 15 percent. For the newer ASEAN members, it refers to all products with applied MFN tariff rates between 15 and 30 percent.
- *Category 3:* For the ASEAN 6 and China, this refers to all products with applied MFN tariff rates lower than 5 percent. For the newer ASEAN members, it refers to all products with applied MFA tariff rates lower than 15 percent.

The EHP was to be implemented no later than 1 January 2004 with time frame and liberalisation schedules as follows:

Table 2.1: China and ASEAN 6

Product Category	Not later than 1 Jan. 2004	Not later than 1 Jan. 2005	Not later than 1 Jan. 2006
1	10%	5%	0%
2	5%	0%	0%
3	0%	0%	0%

Table 2.2: The newer ASEAN members:Category 1

<i>Country</i>	Not later than 1 Jan. 2004	Not later than 1 Jan. 2005	Not later than 1 Jan. 2006	Not later than 1 Jan. 2007	Not later than 1 Jan. 2008	Not later than 1 Jan. 2009	Not later than 1 Jan. 2010
Vietnam	20%	15%	10%	5%	0%	0%	0%
Laos and Myanmar	-	-	20%	14%	8%	0%	0%
Cambodia	-	-	20%	15%	10%	5%	0%

Category 2

<i>Country</i>	Not later than 1 Jan. 2004	Not later than 1 Jan. 2005	Not later than 1 Jan. 2006	Not later than 1 Jan. 2007	Not later than 1 Jan. 2008	Not later than 1 Jan. 2009	Not later than 1 Jan. 2010
Vietnam	10%	10%	5%	5%	0%	0%	0%
Laos and Myanmar	-	-	10%	10%	5%	0%	0%
Cambodia	-	-	10%	10%	5%	5%	0%

Category 3

<i>Country</i>	Not later than 1 Jan. 2004	Not later than 1 Jan. 2005	Not later than 1 Jan. 2006	Not later than 1 Jan. 2007	Not later than 1 Jan. 2008	Not later than 1 Jan. 2009	Not later than 1 Jan. 2010
Vietnam	5%	5%	0-5%	0-5%	0%	0%	0%
Laos and Myanmar	-	-	5%	5%	0-5%	0%	0%
Cambodia	-	-	5%	5%	0-5%	0-5%	0%

The EHP also allows member countries to exclude certain sensitive products from liberalisation. Any party that excludes other ASEAN members or China from tariff concessions through the exclusion list does not receive tariff concessions on those products from the other ASEAN members or China. Singapore, Brunei, Thailand, Indonesia and Myanmar do not exempt any product from tariff reduction or elimination, while Cambodia, Laos, Malaysia, the Philippines and Vietnam exclude some products. Cambodia excludes 30 items from tariff reduction, including live swine, live fish (carp), tomatoes, onions, garlic, cauliflowers, broccoli, cabbages, lettuce, carrots, turnips, coconuts, pineapples, mangoes, oranges, watermelons, melons and longans.

In sum, although motivations to establish the ASEAN-China FTA are both political and economic on both sides, the anticipated economic benefits are the main driving force of this free trade area.

Chapter Three:

Potential Impacts of the ASEAN-China FTA and the EHP on Cambodia

This chapter discusses the implications of the ASEAN-China FTA and the EHP for Cambodia in general, and for its agricultural sector in particular. It first reviews the recent development of economic relations between Cambodia and China, focussing on investment and trade. The structure of trade in EHP products between Cambodia and China in recent years is also discussed in this section. It then looks at the opportunities and challenges of the FTA from the perspective of Cambodia. It assesses the potential impacts of the EHP on agriculture in terms of export opportunities and threats of imports to domestic producers, on trends and the pattern of trade between Cambodia and China with reference to the trade between China and Thailand and Vietnam. The last section looks at some poverty implications of the EHP in terms of the participation of small farmers and the poor in agricultural trade liberalisation.

3.1. Economic Relations between Cambodia and China

Economic relations between Cambodia and China have progressed notably since the 1990s. Prior to the Framework Agreement, Cambodia concluded an investment promotion and protection agreement with China in July 1996 and a bilateral trade agreement in July 1997. These agreements established a platform for trade and mutual investment. China was the fourth largest source of Cambodia's FDI during 1995–2004, investing around \$395 million, or 9 percent of total FDI in Cambodia (Table A.2 in the statistical appendix). China was Cambodia's seventh largest trading partner in 1995 and fourth largest in 2003. Cambodia-China trade grew at an annual rate of 23 percent during 1995–2001 and 62 percent during 2002–05. In 2005, Cambodia's exports to China were \$27.3 million and its imports from China \$536.11 million.

Tables 3.1 and 3.2 show that Cambodia exports natural-resource-based and agricultural products, and imports a wide range of mostly manufactured products: textiles and apparel, iron and steel, ceramics, electrical and electronic equipment, foodstuffs and vehicles. Cambodia's largest export product to China during 2000–05 was wood and wooden articles, constituting more than half of total exports to China and with a total value of around \$132 million. Other major exports to China have been cotton, rubber, fish, crustaceans and live animals. Cambodia's imports from China have been increasing rapidly, from \$164.1 million in 2000 to \$536.11 million in 2005. Textiles and apparel are 63 percent of total imports from China, with a total value of \$1,210 million during 2000–05. The substantial increase in these imports was mostly caused by the increasing demand for inputs to garment production in Cambodia. The second largest import from China is machinery and electrical appliances, valued at \$194.62 million during 2000–05, or 10 percent of total imports from China. Other major imports include meat, fish and seafood preparations, iron and steel, articles of iron and steel, ceramic products and vehicles.

Cambodia-China trade in EHP products, as shown in Table 3.3, is not very significant, accounting for 0.33 percent of total trade during 2000–05. During the same period, Cambodia's EHP exports accounted for about 2 percent of its total exports to China. Live fish was the largest export item during 2000–05, valued at \$3.99 million and followed by shrimps and prawns, live animals and mushrooms and truffles with total values of \$2.36 million, \$1.12 million and \$29,894 respectively. Cambodia's EHP imports amounted to \$3.43 million during

2000–05, or 0.18 percent of total imports from China. During the same period, garlic was the largest EHP import at \$1.37 million, followed by apples and mushrooms and truffles at \$946,635 and \$547,525 respectively. The remaining imports from China under EHP are pears and quinces, red beans, honey and fish.

Table 3.1: Cambodia's Exports to China, 2000–05 (\$ million)

HS code	Product Description	2000	2001	2002	2003	2004	2005
	All products	59.49	34.8	24.55	26.17	29.56	27.3
44	Wood and articles of wood, wood charcoal	50.27	27.03	15.12	13.64	15.06	11.1
52	Cotton	-	0.44	0.1	3.15	8.85	7.56
40	Rubber and rubber articles	5.41	5.71	7.48	7.68	2.53	3.13
03	Fish, crustaceans, molluscs, aquatic invertebrates	1.07	0.93	1.28	1.13	1.28	0.73
62	Apparel, accessories, not knitted or crocheted	2.5	0.08	0.04	0.04	0.68	1.79
33	Essential oils, perfumes, cosmetics, toiletries	-	-	-	0.09	0.06	1.08
01	Live animals	0.21	0.24	0.32	0.06	0.04	0.24

Source: Global Trade Atlas

Table 3.2: Cambodia's Imports from China, 2000–05 (\$ million)

HS Code		2000	2001	2002	2003	2004	2005
1-99	All products	164.1	205.58	251.6	294.59	452.33	536.11
50-63	Textiles and apparel	78.54	109.94	154.11	205.77	297.45	364.74
52	Cotton	32.68	49.85	62.15	79.24	118.27	127.232
55	Artificial staple fibres	8.5	11.03	17.32	15.88	32.17	38.51
54	Artificial filaments	4.27	6.15	8.12	12.64	20.42	24.44
58	Special woven or tufted fabric, lace, tapestry etc	3.27	3.31	10.82	11.7	21.08	20.17
60	Knitted or crocheted fabric	21.67	30.38	44.44	70.85	85.98	123.54
61	Articles of apparel, accessories, knitted or crocheted	6.38	6.82	6.6	9.37	8.97	20.84
84-85	Machinery and electrical appliances	25.08	26.42	30.74	22.22	37.55	52.61
84	Boilers, machinery, etc	11.13	11.79	20.12	14.32	22.02	34.28
85	Electrical, electronic equipment	13.95	14.63	10.62	7.9	15.527	18.33
	Other						
16	Meat, fish and seafood preparations	-	-	-	-	19.67	14.31
72	Iron and steel	12.01	8.48	6.27	9.01	14.03	9.84
69	Ceramic products	3.26	4.87	7.52	10.34	13.88	22.53
73	Articles of iron or steel	4.18	7.35	13.45	0.95	9.13	5.85
87	Vehicles other than railway and tramway	3.61	3.25	3.27	10.78	6.71	7.38

Source: Global Trade Atlas

Table 3.3: Cambodia's Trade with China of Products Covered by EHP, 2000–05 (\$)

HS Code		2000	2001	2002	2003	2004	2005
Exports							
030623	Shrimps and prawns	609,528	90,916	211,676	426,802	720,801	301,581
030199	Live fish	463,849	835,612	1,062,945	682,791	520,214	420,178
010600	Live animals	209,515	242,728	317,217	63,748	40,000	243,500
071239	Dried mushrooms and truffles	-	-	-	-	-	29,894
Imports							
070320	Garlic, fresh or chilled	-	48,320	78,680	526,466	720,278	-
070310	Onion and shallots, fresh or chilled	-	2,601	-	-	15,306	-
080810	Apples, fresh	93,407	23,077	32,257	47,834	287,098	556,369
080820	pears and quinces, fresh	10,065	21,548	29,366	4,620	130,192	143,349
071239	dried mushrooms and truffles	-	-	-	42,187	279,078	226,260
071332	Beans, small red (adzuki) dried, shelled	-	-	-	16,588	32,890	-
040900	Honey, natural	-	-	-	12,588	3,147	1,593

Source: *Global Trade Atlas*

3.2. ASEAN-China FTA: Opportunities and Challenges for Cambodia

The ASEAN-China FTA is likely to create both opportunities and challenges for Cambodia. Opportunities are both economic and non-economic, while challenges include concerns over potential negative impacts on domestic producers and farmers, and institutional and policy reforms to derive the greatest benefits from this trade liberalisation scheme.

3.2.1. Opportunities

The FTA will allow Cambodia's exports access to the fast-growing and dynamic Chinese market. This is critical for a small country like Cambodia, whose domestic market is not large. Enhanced market access can induce Cambodian enterprises to produce more efficiently.

Second, the elimination of tariff and non-tariff barriers may facilitate trade flows and promote specialisation based on factor endowment. According to trade statistics, Cambodia exports natural-resource-based and agricultural products such as rubber, wood, live animals, live fish, shrimps and prawns; it imports from China a wide range of manufactured products such as iron and steel, ceramics, electrical and electronic equipment, foodstuff and vehicles. This trade pattern indicates high complementarity in exports between Cambodia and China, which should result in more specialisation and gains when trade is liberalised.

Third, besides the reduction and elimination of tariff and non-tariff barriers, the Framework Agreement provides for a more open, transparent and competitive investment regime. This may facilitate investment flows to explore economic opportunities associated with country competitiveness and comparative advantage. Cambodia has a potential comparative advantage in the primary sector due to its abundance of cultivable land, but is short of skills (Toshiyasu, Chan and Long, 1998³). However, investment in this sector accounts for only 5 percent of total investment (see Table A.1 in the statistical appendix). The EHP can be expected to increase investment in agriculture to take advantage of market access. In addition, there is potential that labour-intensive and basic manufacturing sectors in the

3. These writers investigate determinants of comparative advantage of selected ASEAN countries based on empirical evidence from a cross-country study by Wood Adrian (1994): *Skills, Land and Trade: A Simple Analytical Framework*. IDS working paper 1 (Brighton: Institute of Development Studies)

ASEAN 6 and China might move to countries with a lower level of development, like Cambodia, as they develop and shift their economies toward technological and knowledge-intensive industries. This pattern occurred in East Asian development from 1965 to 1990, where industries such as textiles, manufacturing and automobiles moved from Japan to Taiwan and Hong Kong and then to Thailand, Malaysia and China.⁴

An ASEAN-China FTA may also create a number of non-economic opportunities such as strengthening relations and cooperation in areas such as tourism, information and communications technology, human resource development and security. It may also foster closer cooperation between China and Cambodia in the GMS.

3.2.2. Challenges

The FTA will pose many major challenges for Cambodia: implementing key reforms required for compliance, making best use of liberalisation schedules, improving the competitiveness of domestic enterprises and finding measures to mitigate negative impacts. One of the biggest challenges is the need to build the capacity of the private sector, especially small and medium enterprises, to supply the regional market. Cambodian enterprises are at a stage of limited production and marketing capacities. Limited capacity and an unfavourable business environment inhibit enterprises from making the best use of market access. The experience in the ASEAN Free Trade Area (AFTA) is that Cambodia has made very little use of liberalisation by other member countries. Although other ASEAN members' tariffs on most goods have been significantly reduced under the common effective preferential tariff (CEPT), Cambodian exports to ASEAN have not increased significantly. Many people believe that this is largely because Cambodian producers face several major supply-side constraints, including an unfavourable investment and business climate, an insufficient regulatory framework, a lack of efficient institutions and good governance, inadequate physical infrastructure, a lack of access to finance and business support services and a lack of managerial and technical skills. Given the lack of institutional capacity and the other development priorities of the government, addressing supply-side constraints as well as increasing Cambodian exports will be very challenging.

Another major challenge is to create mechanisms to mitigate potential negative impacts. When trade barriers are dismantled, some industries will likely expand and others contract as a result of competition. There may be uneven distribution of costs and benefits among different sectors and industries. When tariffs on traded goods are eliminated, Cambodia's markets may be flooded by cheaper imports from China, creating intense competition with domestic producers. Domestic firms that are not able to compete with imported goods could then be crowded out. The closure of some producers may trigger short-term loss of jobs, income decline and movement into poverty. Although Cambodia has been provided more flexibility and additional time to adjust, difficulties are anticipated because of a lack of financial resources and institutional capacity to implement reforms.

Another concern for Cambodia is how to diversify revenue sources away from trade taxes as a means to finance growth and development. Tariff reduction may cause a reduction of revenues and thus some difficulties for fiscal policy. Poor fiscal performance might disrupt necessary expenditures in areas such as education, health and agriculture. This could, in turn, disrupt development.

3.3. Potential Impacts of the EHP on Cambodian Agriculture

Agriculture in Cambodia is characterised by backward technology, high weather dependence, low productivity and uneven growth. It accounts for 31 percent of GDP and employs about 70 percent of the total labour force (CDRI, 2005). Lack of private investment and export-

4. World Bank (1993), *The East Asian Miracle: Economic Growth and Public Policy*, World Bank Policy Research Report (Washington, DC: World Bank).

oriented production keeps this sector at a subsistence level, and thus its potential comparative advantage has not fully materialised. With the EHP, Cambodia's agricultural exports are expected to increase gradually. Increases in agricultural exports, in turn, could result in more resources and private investment to develop this sector further.

Trade patterns between China and Thailand and China and Vietnam, shown in Table A.3 in the statistical appendix, suggest that the Chinese market has a huge demand for chapter 7 products (edible vegetables and certain roots and tubers), chapter 8 products (edible fruits and nuts) and chapter 3 products (fish, crustaceans and aquatic invertebrates). In 2005, China imported \$341 million of cassava from Thailand and \$50 million from Vietnam. It also imported \$180 million of edible fruits and nuts, and \$57 million of fish, crustaceans and aquatic invertebrates from Thailand. The trade statistics in Table A.3 also suggests that fresh fruits such as pineapples, mangoes, mangosteens, durians, longans and bananas as well as cassava, fish, shrimps and prawns are China's major agricultural imports from ASEAN countries. Among these, fish, shrimps and prawns are Cambodian exports, and some others are potential Cambodian exports. Thus, market access via the EHP and the huge demand for these products in the Chinese market could stimulate expanded production of such goods. Cassava is also a potential for Cambodian export to China provided that the competitiveness of Cambodia's cassava is comparable to that of Thailand and Vietnam. In addition, the EHP creates high potential for Cambodia to export fresh fruits like durians, pineapples, longans and bananas. Although Cambodia has excluded pineapples, mangoes, mangosteens, durians, longans and bananas from tariff reduction in the EHP schedules, it could still enjoy certain tariff preferences from China because it has been granted special and preferential treatment on 380 tariff lines, of which 155 are products covered by the EHP. The production of Cambodian fresh fruits is mostly organic, and the taste is different from that of the fruits of Vietnam and Thailand. The differences could make it easier for Cambodia's fresh fruits to penetrate the Chinese market as niche products, avoiding direct competition with those from other countries.

Another opportunity associated with the EHP is the export of cashew nuts. Cambodia's production of cashews is expanding, especially for foreign markets. China imports considerable amounts of cashews from Thailand. Given preferential tariffs under the EHP and market demand, Cambodian cashews nuts are likely exports to China and thus production would grow.

It would be difficult for Cambodia to export fish, shrimps and prawns, because it has strong competitors in Thailand and Vietnam, which have been granted similar preferential treatment. These countries are major exporters of these commodities and produce more efficiently than Cambodia. If Cambodia's exports of these products cannot find niche markets, they would be vulnerable to direct competition. The statistics in Table 3 indicate a gradual decline of these exports, and the trend in coming years will probably not change significantly unless these products find a niche market.

The potential impacts of the EHP on Cambodian domestic producers seem not very significant. The statistics on trade in EHP products between Cambodia and China in Table 3.3 suggest that the exports between Cambodia and China are highly complementary. China exports products like apples, pears and quinces that cannot be produced locally. Furthermore, the potential negative impacts on domestic producers and farmers seem not significant because certain products that small farmers produce for the domestic market—tomatoes, onions, garlic, cabbages, carrots, turnips—are excluded from EHP tariff reduction. Farmers, however, have already been hurt by a flood of imports of these products from Vietnam, and Chinese products probably could not compete with the Vietnamese. Judging from the current trade pattern between Cambodia and China, it is likely that other EHP products would not be negatively affected in a major way by imports from China.

3.4. Poverty Implications

Cambodia is one of the poorest countries in the region, with widespread and severe poverty as a consequence of great destruction and conflict for several decades. About 35 percent of Cambodians live below the poverty line; and the majority of the poor are in households whose heads are employed in agriculture (World Bank, 2006).

The EHP is likely to provide opportunities to develop certain agricultural products via trade with China. The degree of benefit for the poor depends on the extent to which they, especially the rural population, participate in this trade-oriented activity, through either supplying export goods or working in competitive sectors and associated jobs. The net benefits for the poor also depend on whether regional and domestic policies favour the poor. The EHP will benefit the poor if policy is structured to develop agricultural production and marketing systems that will assist small farmers to supply agricultural products in a cost-effective and competitive manner. Farmers would also benefit from policy that helps local enterprises, especially small and medium enterprises, to gain the capacity to compete in regional and international markets. The more small farmers and the poor participate in agricultural trade-related activities associated with the EHP, the higher the possibility that poverty in Cambodia will be reduced.

Furthermore, it is necessary to have adjustment measures to mitigate potential negative impacts of trade liberalisation. Government support and policy interventions to provide safety nets and alternative employment opportunities for small farmers and the poor during the liberalisation process are necessary.

In sum, agriculture in Cambodia is not likely to be significantly affected by the EHP, at least in the short and medium terms. On the contrary, the EHP is expected to provide Cambodian agriculture with export opportunities, especially for fresh fruits, through market access at preferential tariff rates. The expansion of agricultural production and exports will have significant implications for poverty reduction if national policy is structured to support participation of the poor in agricultural trade-related activities.

Chapter Four: Cambodia's Trade Agreements

This chapter provides a brief overview of Cambodia's global, regional and bilateral trade agreements. Cambodia's commitments after accession to the WTO, the modality of tariff reduction and elimination under CEPT/AFTA, GMS support programmes and characteristics of bilateral trade are elaborated upon, followed by discussion of the implications of those trade agreements for Cambodia's agriculture. For more than a decade after its transition to a market economy, Cambodia has made significant progress integrating into the global and regional economies. Cambodia acceded to the World Trade Organisation with commitments to comply with multilateral trading rules and principles. Regionally, Cambodia became a member of ASEAN and the AFTA in 1999 and a signatory of the Framework Agreement in 2002. Cambodia is also a member of the GMS, which aims to promote closer economic ties and cooperation. As well, Cambodia has entered into bilateral trade agreements with numerous countries, including China, the European Union, Indonesia, Laos, Malaysia, the Philippines, Russia, Thailand, the United States and Vietnam. These agreements are primarily aimed at promoting cooperation through normalising economic and trade relations and providing MFN treatment, rather than liberalising trade through tariff reduction and elimination. These developments indicate that Cambodia's trade policy has been more opened and liberalized in response to proliferation of regionalism and globalisation.

4.1. Global

Cambodia became the 148th member of the WTO on 13 October 2004. Cambodia fully enjoys the rights and obligations of all members under WTO agreements, such as the obligation of non-discrimination and the right to use WTO dispute settlement procedures. At the same time, Cambodia is required to comply with WTO rules and principles. As a result, Cambodia is committed to adopt a series of regulations that would strengthen the judicial system regarding commercial activities, respect trade-related intellectual property rights, facilitate a smooth functioning of external trade and promote financial intermediation. Furthermore, Cambodia has made numerous commitments to ensure that its trade policy and practices are fair and non-discriminatory, transparent and predictable. The commitments specified in the Report of the Working Party on the Accession of Cambodia (WT/ACC/KHM/21) relate to state ownership and privatisation, pricing policies, tariff rates, quotas and tariff exemptions, quantitative import restrictions, export restrictions, export subsidies, anti-dumping measures, countervailing duties and safeguard regimes, customs valuation, pre-shipment inspection, rules of origin, industrial policies, agricultural policies, standards and certifications and textiles regime (see appendix).

Cambodia's WTO membership could serve as a tool for domestic reforms that are primarily designed to provide transparent legal frameworks and a fair and predictable business environment. These fundamental regulations and frameworks, along with fair and transparent commercial practices, could facilitate the implementation of global, regional and bilateral trade liberalisation schemes. One of the most significant benefits for Cambodia as a WTO member is that its garment exports are no longer under quota restriction after the

Agreement on Textiles and Clothing ended in January 2005.⁵ This gives Cambodia advantages compared to non-WTO member status and helps to promote the competitiveness of its garment sector, which has been a major source of employment, foreign exchange earnings and growth. Another long-term prospect for Cambodia is the opportunity to develop agriculture through greater access to global markets. In the short and medium terms, Cambodian agriculture is not likely to benefit much from this global trading system for two main reasons. First, the progress of WTO negotiations on agricultural liberalisation has been very slow, so considerable constraints and barriers to agricultural trade still exist. Second, production and marketing in Cambodian agriculture are not well developed yet due to constraints such as poor infrastructure, the absence of a clear policy framework, the absence of an efficient marketing system, the absence of adaptable technologies, inadequate extension services and inadequate rural financial structures. This makes Cambodian agriculture less competitive and unable to supply global markets.

4.2. Regional

4.2.1. AFTA

Cambodia joined ASEAN in 1999, which involved automatic accession to AFTA. AFTA was formally established in 1992 with the primary objective of accelerating the liberalisation of intra-ASEAN trade and investment and realising an FTA by 1 January 2003.⁶ The CEPT is the key instrument to reduce tariffs on all manufactured goods, including capital goods, processed agricultural products, agricultural goods⁷ and non-agricultural products. The CEPT categorised traded goods for tariff reduction into four lists—the inclusion list (IL), the temporary exclusion list (TEL), the sensitive list (SL) and the general exception list (GEL) (Kanokpan Lao-Araya, 2002). The IL consisted of items subject to immediate tariff reductions to reduce them to 0–5 percent by 2003. The TEL referred to products for which tariffs would ultimately be lowered to 0–5 percent, but which were temporarily protected. The SL was unprocessed agricultural products to be phased into the IL between 2001 and 2003, and to be in the 0–5 percent tariff range by 2010. The GEL referred to products which countries deemed necessary for the protection of national security, public morals, human, animal or plant life and health and articles of artistic, historic or archaeological value.

Cambodia's exports of agricultural products to ASEAN markets are significantly less than its imports. The elimination of trade barriers under CEPT/AFTA caused substantial increases of agricultural imports from Vietnam and Thailand. From this experience, it seems that Cambodian agriculture has not derived significant benefits from AFTA for two main reasons. First, there are similarities in agricultural exports among Cambodia, Vietnam, Thailand, Indonesia and Laos. This caused intensified competition, and countries like Vietnam and Thailand, which can produce more competitively, dominate the regional market. Second, Cambodian agriculture is primarily subsistence oriented, and development of this sector faces several constraints. This keeps Cambodia's agricultural competitiveness relatively low.

4.2.2. GMS

Cambodia is a member of the Greater Mekong Sub-region (GMS), which was established in 1992, with the support of the Asian Development Bank (ADB), among six countries located

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5. This agreement replaced the Multi-Fibre Agreement in 1995 as a transitional instrument to integrate the garment sector fully into normal GATT rules over a 10-year period. In January 2005, global textiles and clothing were no longer under quota restrictions unless qualifying for safeguard measures provided in the agreement.
 6. The original time frame for this liberalization was 15 years from 1993. The 26th ASEAN Economic Ministers Meeting in 1994 shortened the time to 10 years.
 7. In September 1994, the ASEAN economic ministers' meeting decided to include agricultural products in the CEPT.

along the Mekong River: Cambodia, Lao PDR, Myanmar, Thailand, Vietnam and Yunnan province of China. The GMS has the ultimate objective of promoting the development of GMS markets and the movement of goods and people across the common borders. Its key specific objectives include: (1) facilitating sub-regional trade and investment, (2) facilitating sub-regional development opportunities, particularly for energy and tourism, (3) facilitating the resolution of trans-border issues such as contagious diseases and environmental degradation and (4) meeting common resource or other needs. To improve connections and communication across the region, the GMS has emphasised development of transport and economic corridors connecting countries. Other priority areas include energy, telecommunications, environment, human resource development, tourism, trade, private sector investment and agriculture.

Unlike ASEAN and the ASEAN-China FTA, which are formal groupings with legal agreements and an institutional arrangement, the GMS is guided by a set of general principles. The GMS ministerial conference serves as a forum for outlining agendas, discussing key issues and deciding on general areas of concentration. The GMS is also different in the way that it has primarily focused on physical infrastructure, especially cross-border infrastructure, in response to inadequate and underdeveloped infrastructure in most member countries. Initiatives for economic corridors, for example, will create road networks connecting countries, reduce transportation costs and facilitate movement of goods and people. The GMS has also attempted to address certain “software” issues such as facilitating cross-border trade and investment, developing human resources and skills and improving procedures and transparency of customs clearance. The GMS programme, therefore, is helpful and complementary to regional arrangements like ASEAN and the ASEAN-China FTA, especially in terms of physical infrastructure.

4.3 Summary

Cambodia's economic integration into regional and global trading systems could provide a greater opportunity for its agriculture to grow through exports to international markets. However, Cambodian agriculture has not fully benefited from these preferential trade arrangements, for two main reasons. First, some barriers, especially non-tariff barriers such as subsidies and quality assurance requirements, still exist in almost all trading arrangements. This makes it hard for exports from a small country like Cambodia to compete in international markets. Second, the productivity and competitiveness of Cambodian agriculture are relatively low as a result of institutional, policy, technical and operational constraints.

Chapter Five:

Constraints and Policy Responses

This chapter elaborates the constraints on agricultural development and major impediments to business operations that prevent Cambodia, especially the agricultural sector, from fully benefiting from market access through various trade agreements, especially the EHP. It also suggests policy responses to develop agriculture and to strengthen supply-side capacity in order to harness the economic opportunities.

5.1. Overall Constraints on Agriculture and Business

Agriculture and related enterprises in Cambodia have faced institutional, policy, technical and operational constraints. While impediments such as weakness in legal and policy frameworks, infrastructure and the capacity and effectiveness of government bureaucracy are common to both agriculture and business, some others are specific. For example, low productivity and a lack of agricultural extension services are major impediments to agricultural development, while the lack of an educated and skilled workforce and access to finance are major impediments to business. Although Cambodia is provided market access for its agricultural products through various trade arrangements, the sector has not been able to benefit fully from those preferential schemes, largely due to major supply-side constraints. Because trade in agriculture depends heavily on competitiveness, policy interventions and measures to address constraints on agricultural growth and impediments to business operations would help to promote agricultural exports to global and regional markets.

5.1.1. Constraints on Agricultural Growth

Significant challenges to Cambodian agricultural development remain. These include poor infrastructure, the absence of a clear policy framework, the absence of an efficient marketing system, the absence of adaptable technologies, and inadequate extension services.

Poor infrastructure: A lack of basic infrastructure such as irrigation systems, roads and transport is a major impediment to increasing farm productivity, and thus to agricultural growth (CDRI, 2005).

Absence of an efficient marketing system: According to CDRI (2005), market mechanisms to facilitate the movement of agricultural products from farmers to end-users (both domestic and international markets) do not function well. Farmers seem to have less bargaining power than middlemen, and their products are priced much lower than they would be if market competition existed. At present, there is no national marketing institution. Only the Market Information Service under the Ministry of Agriculture, Forestry and Fisheries, which receives assistance from the FAO, is undertaking marketing development.

Low productivity: According to CDRI (2005), current yields of rice and other cash crops are very low compared with many south-east Asian countries. In most lowland areas, poor soil fertility is a major production constraint that must be addressed by suitable soil and fertiliser management. The low degree of irrigation, coupled with the poor performance of existing irrigation facilities, discourages diversification of farming. Without good water management and control, farming remains highly risky.

Inadequate extension services: The arrangements and mechanisms for delivering agricultural support services such as extension programmes are either not in place or are inadequate

(CDRI, 2005). It is widely recognised that agricultural extension services are very weak, and a fully functioning system for extending support services—and, more importantly, spreading technology—to the rural population has yet to be established. Technical information is mainly conveyed through informal channels, which include neighbouring farmers, non-government organisations, agricultural technicians and distributors of farm inputs. Farmers have very limited access to improved technologies because extension services are not supported by R&D. State institutions are unable to deliver on a timely basis essential services and functions in support of productive, intensive and diversified farming.

Absence of a clear policy framework: The interpretation and enforcement of regulations are not consistent and predictable, and export procedures are complicated and troublesome (World Bank, 2004). For example, many rice millers and wholesalers in the north-west complain about the difficulty and high cost of obtaining an export licence. Moreover, there are still many regulations that make legal export unattractive. As a result, the export of most agricultural products is carried out illegally.

5.1.2. Constraints on Business Operations and Growth

Enterprises in Cambodia face various major constraints—ranging from the macroeconomic environment, overall policy and regulatory framework and public institutions to infrastructure and human resources—making it very hard for them to improve competitiveness.

Corruption has been identified as the leading constraint on business in Cambodia.⁸ It diminishes willingness to invest by adding many hidden costs. Corrupt practices have been described as pervasive, particularly in connection with import and export permits, judicial decisions and the awarding of public contracts. Corruption is also common in other business activities, such as those relating to public utilities and tax payments (EIC, 2005).

Ineffective government bureaucracy is also seen as a major impediment. According to the World Bank (2004: 21), “Cambodia’s bureaucracy is politicized, cumbersome and inefficient, and this creates problems for both potential and existing businesses”. Lack of good governance and transparency is pervasive in public institutions. The country’s public institutions are among the worst in the world and are relatively weak in two areas: contract and law enforcement and governance/transparency. The judiciary is seen as not independent from external influences, while the legal framework is inefficient for settling private businesses disputes or challenging the legality of government actions.

Lack of an educated workforce and physical infrastructure also appears as a major impediment. As a result of the destruction during the Khmer Rouge period and decades of conflict, the human resources available to both public and private institutions are severely limited. Beyond human and social capital, physical infrastructure is lacking. Cambodia’s indicators for road density, telecommunications density, electricity generation and availability of water are among the lowest in the east Asia and Pacific region (World Bank, 2004). The EIC’s Executive Opinion Survey produced similar findings. According to the survey, 85 percent of business executives assess infrastructure in general as inadequate and of low quality. Public utilities are too expensive and subject to frequent supply interruptions; railways, port facilities and inland waterways are relatively underdeveloped. Although access to mobile telecommunications technology is widely considered as comparable to the world’s best, most public infrastructure is perceived to be underdeveloped.

Lack of access to financing is also seen as a major problem for business. Local financial institutions are still in their infancy and far behind international banking institutions in products and services (EIC, 2005). There is no stock exchange in Cambodia for raising equity capital. It is difficult, if not impossible, to secure a bank loan with only a good business plan and no collateral.

8. Both the World Bank survey of investment climate and the Executive Opinion Survey 2005 of the Economic Institute of Cambodia suggest that corruption is the most problematic factor for business.

Regulatory uncertainty and regulatory burdens are also identified as substantial constraints on firms. The interpretation and enforcement of regulations are not consistent and predictable. Seventy-six percent of firms surveyed identified laws and policies affecting them as to some extent unpredictable (World Bank, 2004). In addition, certain categories of regulation, such as customs and trade, business registration, business inspections, environmental regulations and labour regulations, constrain exporters considerably more than firms producing for the domestic market.

5.2. Policy Recommendations

5.2.1. Developing Cambodian Agriculture

To develop Cambodian agriculture, it is necessary to address the overall constraints facing this sector. Bold commitments and further resources should be devoted to providing sufficient basic infrastructure, extension services and effective public institutions. In addition to addressing overall constraints on agriculture, additional policy attention should be devoted to developing specific agricultural products that have high potential for export to China.

Provide an enabling environment

Clearly, Cambodia needs an improved enabling environment for the agricultural sector. Effective public institutions, an adequate regulatory framework, sound policy framework and adequate infrastructure are the key components that support an enabling environment. The government should make a bold commitment and take measures to improve the enabling environment; development donors should provide further financial and technical assistance to the government, but with close supervision of progress and achievements.

Establish special agricultural development zones (SADZ)

The establishment of SADZ was recommended by a study on improving the marketing system for maize and soybeans in Cambodia (CDRI, 2005). The establishment of SADZ would be very practical for developing specific products based on geographic characteristics. The SADZ strategy has several strengths compared to the “normal” strategy. First, it helps the government to concentrate on a particular area, thereby channelling scarce resources and management to a smaller area for maximum impact, rather than dispersing attention over a wider, less manageable space. Second, it is easy to monitor, pilot and bring about changes and improvements, as well as to create the necessary infrastructure and services, including marketing, storage, transport and processing. Third, it would be a tangible move to attract others to join in development collaboration through learning by doing.

Encourage private sector involvement (with donor assistance)

To proceed with SADZ, it is imperative that a framework for joint ventures be developed. Given the risk, at least as perceived by many potential foreign investors, a comfortable level of administrative assurance is crucial. The government could invite selected foreign governments to assist it in developing such a framework, or apply existing ones to a designated SADZ. In this process, private sector involvement would be of the utmost importance. Since the present business-as-usual situation for agricultural development in Cambodia is not good for anyone, Cambodia has very few options but to seek a collaborative strategy that would generate business development initiatives. Such strategic moves are a crucial part of the business development framework and the implementation of SADZ. Cambodia could seek technical and financial assistance from its major donors, which include the ADB, China and the EU, and from other major trading partners that aim at developing a long-term economic relationship with Cambodia.

5.2.2. Building Supply-Side Capacity and Competitiveness

In its diagram of building blocks for enhancing supply-side capacities, UNESCAP (2004) has identified an enabling policy and regulatory framework and efficient institutions and good

governance as the first layer or foundation, and general education and infrastructure as the second layer. These components are key to supporting other necessary measures to increase productivity, which include access to finance, business support services, managerial and technical skills and increased linkages to global supply. The foundation also supports measures to reduce the costs of trade such as streamlined procedures and documentation and to improve transport and information communications technology and market information. To build supply-side capacity and competitiveness, it is necessary to improve the foundations and productive capacity and reduce the costs of conducting trade.

Improving the foundations

There is general agreement in the business community that certain reforms, such as public administrative reforms, legal and judicial reforms and financial and banking reforms, are most critical. In addition, social and economic infrastructure should be further developed to respond to the needs of the private sector. An adequate power supply, good roads, railways, ports and information and communication networks provide the basis for efficient transport and communication and are thus of crucial importance for an internationally competitive private sector.

Enhancing productive capacity

Government can take a multitude of measures to enhance the productive capacity of enterprises:

- Promote private sector provision of business services.
- Encourage and follow up lending by commercial banks to firms, especially SMEs, and encourage the establishment of credit bureaus and partnerships between business development service providers and financial services providers.
- Set up mechanisms to ensure good corporate governance.
- Promote and facilitate FDI. Set up mechanisms to enhance backward and forward linkages between foreign and domestic enterprises as well as between large and small domestic enterprises.

Reducing the cost of conducting trade

Trade facilitation measures suggested in the government's 12-point plan to improve the investment climate and trade facilitation should be strictly implemented. Certain measures should receive immediate attention, including streamlining trade and customs regulations and procedures, simplification and harmonisation of trade documentation and computerisation and automation of trade and customs procedures. It is also recommended that trade finance infrastructure be developed to allow firms, especially SMEs, to finance trade transactions and manage the risks involved.

5.2.3. Building Economic and Business Cooperation with China

The government should approach China for technical assistance to develop agricultural production and productivity with particular focus on products that have the greatest potential for export to China. The government should also negotiate with China to ease certain non-tariff barriers so that Cambodian products can meet export requirements more easily. In addition, the government, together with business associations, needs to strengthen business relationships with China. Cambodian enterprises would benefit in terms of market information, marketing techniques and competition from regular exchange visits, establishment of representative offices in China and other kinds of support from business associations in China. Both governments and private sectors of the two countries need to work together to facilitate and build such networks.

Chapter Six: Conclusion

The EHP of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China comes at a time when the government is committed to developing agriculture through global and regional trade. Given the experiences of other countries such as Thailand, the EHP offers promising prospects for agricultural development and economic growth in Cambodia through export opportunities of products such as fresh fruits, livestock, fish, shrimps and prawns. However, it is virtually impossible for entrepreneurs to take advantage of new opportunities associated with the EHP in the absence of macroeconomic stability, a sound business climate, adequate legal frameworks, sufficient infrastructure and effective government institutions. Cambodia has not yet fulfilled these prerequisites. As a result, its agriculture and enterprises face several institutional, policy, technical and operational constraints.

Addressing all major constraints to agricultural development and supply-side capacity is strongly recommended if Cambodia is to derive the greatest benefits from the EHP. Public administration reforms and legal and judicial reforms should be undertaken to make public institutions more effective, transparent and accountable, thus reducing corruption. Social and economic infrastructure and enabling policy as well as the regulatory framework should also be improved in order to make the climate more conducive to business. There is also urgent need to improve agricultural productivity and competitiveness, enhance the productive capacity of enterprises and reduce the cost of conducting trade, especially through trade facilitation measures. There should also be strong policy intervention to develop the agricultural products that have high potential for export to China via the EHP. Further technical assistance and development assistance from China and closer cooperation among business associations of the two countries are both very necessary and useful for promoting trade.

For the EHP to have a greater impact on poverty reduction, government should also promote the involvement of the poor in trade liberalisation and growth. There should be proper adjustment measures to mitigate potential negative impacts on the poor. The future of agriculture and the contribution of the EHP to poverty reduction in Cambodia depend on the success of the government's policy and reform programmes to enhance agriculture and enterprise competitiveness.

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Appendix

Some highlights of commitments specified in the Report of the Working Party on Accession (WT/ACC/KHM/21) were:

- *State ownership and privatisation:* Cambodia will ensure transparency, keep WTO members informed and provide periodic reports on other issues related to the economic reforms to which it is obligated.
- *Pricing policies:* Cambodia will apply price controls in a way that is consistent with the WTO, and take account of the interests of exporting WTO members. Cambodia has published a list of goods and services subject to state control.
- *Trading rights:* Responding to a comment that its restrictions on imported pharmaceuticals and veterinary medicines could discriminate in favour of domestic production of similar products, Cambodia indicated that it would amend its legislation, and ensure that its laws and regulations are in full conformity with its WTO obligations no later than 1 June 2005.
- *Other customs duties and charges:* Cambodia will ensure these comply with WTO provisions from the date of accession and will be bound at zero.
- *Tariff rate quotas, tariff exemptions:* Cambodia confirmed that it would respect WTO disciplines on tariff rate quotas. Cambodia said that any tariff exemptions would be implemented only in conformity with WTO provisions.
- *Fees and charges for services:* All fees and charges for services related to imports and exports will conform with WTO agreements. From the date of accession, Cambodia will not apply, introduce or reintroduce any fees and charges for services that were applied to imports *ad valorem* (as a percentage of the price).
- *Internal taxes:* From the date of accession, Cambodia will apply its domestic taxes in strict compliance with Article 3 of the GATT and in a non-discriminatory manner to imports. Article 3 deals with “national treatment” (or non-discrimination between locals and foreigners) in taxation.
- *Quantitative import restrictions, including prohibitions, quotas and licensing systems:* No later than 1 June 2005, Cambodia will eliminate quantitative restrictions on imports of fertilisers, pesticides and other agricultural inputs and establish a WTO-consistent method of registration and review of imported agricultural chemicals. From 1 January 2007 Cambodia will rely on the provisions of the Technical Barriers to Trade Agreement to regulate domestic and international trade in these items. After accession, Cambodia will not introduce, re-introduce or apply other non-tariff measures such as licensing, quotas, prohibitions, bans and other restrictions having equivalent effect that could not be justified under the provisions of WTO agreements.
- *Customs valuation:* Cambodia will fully implement the Customs Valuation Agreement from 1 January 2009.
- *Rules of origin:* Cambodia will comply fully with the provisions of the WTO Rules of Origin Agreement by 1 January 2005, parts by 1 January 2004.
- *Pre-shipment inspection:* From accession, the government will take full responsibility to ensure that the operations of the pre-shipment inspection companies retained by Cambodia meet the requirements of WTO agreements. Cambodia’s pre-shipment inspection regime will be temporary and will cease when the Customs and Excise Department is able to carry out the functions currently performed by pre-shipment inspection service providers.

- *Anti-dumping, countervailing duties, safeguard regimes:* Cambodia will not apply any anti-dumping, countervailing or safeguard measures until it has notified and implemented appropriate laws and regulations conforming with WTO agreements. After that, Cambodia will apply any anti-dumping duties, countervailing duties and safeguard measures only in full conformity with relevant WTO provisions.
- *Export restrictions:* Cambodia restricts exports of rice, round logs, unprocessed timber, forestry products, antiques more than 100 years old, narcotic drugs and poisons, weapons, explosives, ammunition and vehicles and machinery for military purposes. From the date of accession, Cambodia will ensure that restrictions comply with WTO agreements.
- *Export subsidies:* Cambodia will comply with the subsidies agreement after accession. It will either eliminate the existing system of remission of import fees and waiver of duty for certain goods used by certain investors, or establish a functioning duty drawback system consistent with WTO provisions, through amendment of the Law on Investment, as necessary, by the end of 2013.
- *Industrial policy, including subsidies:* These subsidies are to be notified from the date of accession.
- *Standards and certification:* Cambodia will gradually implement the Technical Barriers to Trade Agreement. Full implementation will start from 1 January 2007 without recourse to any further transitional period.
- *Trade-related investment measures (TRIMs):* Cambodia will not maintain any measures inconsistent with the TRIMs agreement and will apply the agreement from the date of accession without any transitional period.
- *State trading entities:* Cambodia will apply its laws and regulations governing the trading activities of state-owned enterprises in full conformity with the provisions of the WTO agreement.
- *Free zones, special economic areas:* Free zones or special economic areas, including special promotion zones established in accordance with the Law on Investment, will be fully subject to the WTO agreements and Cambodia's commitments in its protocol of accession. Cambodia will ensure enforcement of its WTO obligations in those zones or areas. In addition, goods produced in these zones or areas under tax and tariff provisions that exempt imports and imported inputs from tariffs and certain taxes will be subject to normal customs formalities when entering the rest of Cambodia, including the application of tariffs and taxes.
- *Transit:* Cambodia will apply any laws, regulations and practices governing transit operations in full conformity with the provisions of the WTO agreements.
- *Agricultural policies:* Cambodia binds its agricultural export subsidies at zero, and will not maintain or apply any export subsidies for agricultural products.
- *Textiles regime:* Textiles and clothing import quotas that other members apply to imports from Cambodia will have growth rates applied as provided for in the Agreement on Textiles and Clothing, from the date of Cambodia's accession. These growth rates will end when the Agreement on Textiles and Clothing terminates (in 2005).
- *Trade-related aspects of intellectual property rights (TRIPS):* Cambodia will apply the TRIPS agreement no later than 1 January 2007, with some protection provided in the interim.
- *Transparency:* All laws and regulations will be published according to WTO requirements, and on a web site from 1 January 2004.

Statistical Appendix

Table A.1: Private Investment by Sector 1995–2004 (US\$ million)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Agriculture	6.0	118.5	65.6	51.6	63.9	9.8	5.6	38.9	3.7	12.3
Industry	299.5	416.6	512.5	650.5	162.7	63.1	99.8	57.4	142.6	170.9
Services	1937.4	231.6	166.5	154.7	222.6	150.1	111.4	143.3	167.7	91.8
TOTAL	2242.9	766.7	744.5	856.8	449.1	222.9	216.8	239.6	314.1	275.0

Table A.2: Cambodia's Foreign Direct Investment from China, 1995–2004 (\$ million)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total investment	2243	767	744	854	448	218	205	238	250	210
FDI	1910	619	578	556	196	160	140	145	65	134
Investment from China	3	38	36	105	46	28	5	24	33	77
of which garment sector	0.13	5	16	23	12	0.7	1.7	3	7	32

Source: Cambodia Investment Board, CDC

Table A.3: Chinese Imports from Thailand and Vietnam of EHP products, 2000-2005 (\$)

Code	Description	2001	2002	2003	2004	2005
Thailand						
0714	Cassava, Arrowroot Etc, Fresh Or Dry; Sago Pith	125,024,557	113,486,345	150,256,014	273,152,624	341,252,086
0810	Fruit Nesoi, Fresh	61,950,157	58,365,048	60,030,316	121,214,993	117,806,851
0804	Dates, Figs, Pineapples, Avocados Etc, Fr Or Dried	9,197,746	8,986,787	15,308,504	29,640,417	35,066,498
0303	Fish, Frozen (No Fish Fillets Or Other Fish Meat)	6,734,244	6,638,032	6,683,758	19,797,223	34,503,445
0813	Fruit Dried Nesoi; Mixtures Of Nuts Or Dried Fruit	636,387	1,612,394	5,897,865	27,337,427	21,910,297
0306	Crustcns Lve Frsh Etc, Ckd Etc.; Flrs Mls H Cnsump	14,580,380	9,718,792	11,735,781	11,489,991	13,345,289
0307	Molluscs & Aqua Invert Nesoi, Lve Etc.; Flours Etc	3,249,901	3,451,792	4,145,963	5,060,120	6,160,082
0803	Bananas And Plantains, Fresh Or Dried	158,738	235,251	551,320	1,940,054	3,206,599
0304	Fish Fillets & Oth Fish Meat, Fresh, Chill Or Froz	1,738,620	3,368,253	3,378,163	3,091,854	3,119,648
0805	Citrus Fruit, Fresh Or Dried	497,905	860,755	736,643	439,453	1,613,569
0801	Coconuts, Brazil Nuts & Cashew Nuts, Fresh Or Dry	22,944	91,621	161,966	441,451	454,196
0812	Fruit & Nuts Temporarily Preserved, Not Now Edible	145,234	219,909	270,633	258,158	372,699
0301	Fish, Live	146,586	250,991	60,594	225,752	362,957
0710	Vegetables (Raw Or Cooked By Steam Etc), Frozen	152,891	34,213	39,033	196,853	272,644
0713	Leguminous Vegetables, Dried Shelled	261,299	268,059	162,311	282,719	265,858
0305	Fish, Dried, Salted Etc, Smoked Etc; Ed Fish Meal	333,191	212,460	770,156	296,850	254,216
0811	Fruit & Nuts (Raw Or Cooked By Steam Etc), Frozen	7,004	12,340	9,073	80,761	62,798

Code	Description	2001	2002	2003	2004	2005
0302	Fish, Fresh Or Chilled (No Fillets Or Other Meat)	55,429	43,605	26,112	93,797	33,498
0709	Vegetables Nesoi, Fresh Or Chilled	92,756	99,170	102,404	76,794	19,009
Vietnam						
0714	Cassava, Arrowroot Etc, Fresh Or Dry; Sago Pith	13,221,017	18,586,587	40,620,511	49,492,064	50,373,358
0306	Crustens Lve Frsh Etc, Ckd Etc.; Flrs Mls H Cnsump	4,458,984	1,700,387	1,575,617	4,311,145	8,559,855
0304	Fish Fillets & Oth Fish Meat, Fresh, Chill Or Froz	676,123	711,484	3,815,307	6,663,969	8,524,803
0307	Molluscs & Aqua Invert Nesoi, Lve Etc.; Flours Etc	2,663,104	5,822,056	3,607,061	3,851,195	5,869,177
0305	Fish, Dried, Salted Etc, Smoked Etc; Ed Fish Meal	704,901	2,969,449	2,361,995	422,629	2,716,362
0303	Fish, Frozen (No Fish Fillets Or Other Fish Meat)	166,508	691,687	756,337	303,318	669,432
0711	Vegetables, Temporarily Preserved, Not Now Edible	129,712	312,024	192,026	314,268	257,166
0302	Fish, Fresh Or Chilled (No Fillets Or Other Meat)	14,964	42,453	14,163	77,781	20,102
0713	Leguminous Vegetables, Dried Shelled	7,272	99,676	79,982	184,966	14,981
0709	Vegetables Nesoi, Fresh Or Chilled	24,574	550	-	-	7,849

Source: Global Trade Atlas

A SEAN-China FTA provides advantages and economic benefits to all member countries in terms of increased trade, economic efficiency, investment and strengthened cooperation. The removal of trade barriers between ASEAN and China may lower costs, increase intra-regional trade, increase economic efficiency and improve investment prospects in the region. For Cambodia, the EHP, which is a provision of the Framework Agreement aimed at accelerating liberalisation of trade in most agricultural products, could provide an opportunity to develop its agriculture as a source of growth and poverty reduction. The EHP offers promising prospects for developing agriculture through exporting products such as fresh fruits, livestock, fish, shrimps and prawns to the dynamic Chinese market.

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