



CAMBODIA'S PREPAREDNESS FOR ASEAN ECONOMIC COMMUNITY 2015 AND BEYOND

By Hing Vutha

This article reviews the progress of the ASEAN Economic Community (AEC) and its remaining challenges; assesses Cambodia's preparatory process for AEC and key challenges; and provides policy priorities for Cambodia to leverage AEC and broader Asian regional integration for economic growth and development.

Review of progress towards the AEC: Where does it currently stand? What are the remaining challenges?

AEC stands for ASEAN Economic Community. In 2003 ASEAN leaders affirmed their commitment to realising the AEC by 2020, declaring it as the end goal of regional economic integration that would both establish ASEAN as a single market and production base and transform ASEAN into a more dynamic and integrated regional organisation. The deadline was later brought forward to 2015. The AEC Blueprint, adopted by ASEAN leaders in 2007, sets clear targets and timelines for implementation of various measures. The AEC comprises four broad strategic components: (i) a single market and production base, (ii) a highly competitive economic region, (iii) a region of equitable economic development, and (iv) a region that is fully integrated with the global economy.

Pillar one, a single market and production base, strives to foster intra-regional trade, harmonise standards and ease the movement of goods, services, capital and skilled labour within ASEAN. This will facilitate the development of production networks in the region and enhance ASEAN's capacity to serve as a global production centre and as a part of the global supply chain. It

comprises five core elements: free flow of goods, free flow of services, free flow of investment, freer flow of capital and freer flow of skilled labour. Pillar two, a highly competitive economic region, involves building regulatory frameworks that are harmonised and conducive to business and investment especially in the areas of competition policy, intellectual property rights, taxation and e-commerce. Another approach to achieve this pillar objective is building regional connectivity through infrastructure development. Under Pillar three, equitable economic development, policy measures focus on small and medium enterprises (SME) development and selected ASEAN Integration Initiatives to bridge the development gap at the SME level and between economies so that all member states, especially Cambodia, Laos, Myanmar and Vietnam (CLMV), benefit from economic integration. Pillar four, integration with the global economy, in light of increasingly inter-connected and highly interdependent markets and globalisation of industries, aims to maintain ASEAN's centrality and strengthen its international competitiveness. The approach to global integration is twofold: a coherent approach towards external economic relations through free trade agreements and closer economic partnerships, and enhanced participation in global supply networks.

According to the AEC Scorecard, the monitoring mechanism to chart progress towards regional economic integration, ASEAN has made considerable progress in implementing the AEC. By the end of 2011 it had completed 187 (67.5 percent) of the 277 measures due in the two phases

Hing Vutha is research fellow at CDRI. This publication may be cited as: Hing Vutha (2014), *Cambodia's Preparedness for ASEAN Economic Community 2015 and Beyond*, Development Research Forum Synthesis Report No. 7, September 2014 (Phnom Penh: CDRI) www.cdri.org.kh/download.htm

under review (2008-2011). The biggest strides have been made in integrating into the world economy (85.7 percent). This is hardly surprising given that ASEAN economies trade mostly with the rest of the world. Progress in other areas of the AEC has been modest, with implementation rates of 65.9 percent for Pillar one, 67.9 percent for Pillar two and 66.7 percent for Pillar three. While recognising the achievement to date, ASEAN's progress towards realising AEC 2015 has been criticised for being "too slow". As well as the uneven implementation of agreed measures among ASEAN Member States, many difficult regional issues have not yet been resolved. ASEAN still faces several major hurdles and challenges, as summarised below.

- While tariff rates of most goods have been reduced to zero, intra-ASEAN trade and utilisation of preferential tariffs have been quite low. According to the World Trade Organisation (WTO 2011), preferential trade only accounts for 20 percent of intra-ASEAN trade, with the majority of trade taking place on a most favoured nation basis. Among the impediments limiting the utilisation of preferential tariffs are lack of information, delays, administrative costs of import and export procedures, and difficulty meeting rules of origin requirements (Wong and Wirjo 2013). Furthermore, the margin of preference on most of these tariff lines is very low, taking away much of the incentive to use them (Menon 2013).
- The use of non-tariff barriers such as discriminatory measures, diverse product standards, import bans, import licensing, additional import requirements, technical barriers to trade, and new import procedures has been increasing (Austria 2013). Behind-the-border interventions have also increasingly emerged as a new form of protectionism since the recent global economic crisis (Wermelinger 2011). Little progress has been made to address them and thus they could undermine a higher level of economic integration and the realisation of the AEC by 2015 (Austria 2013).
- Service liberalisation has been very slow. Existing commitments are insufficient; liberalisation in some sectors particularly

in banking and financial services has been hampered by a flexibility clause that allows member states to liberalise according to each country's readiness (Nikomborirak and Jitdumrong 2013). In addition, statutory or constitutional limitations on foreign equity, restrictions on land ownership and impediments to professional or labour mobility across national boundaries also continue to work against fulfilling services liberalisation commitments (Severino and Menon 2013).

- Liberalisation of people movement in the AEC has shown slow progress, covers only a small proportion of labour and neglects the larger labour segment; negotiation on Mutual Recognition Arrangements has been complex, and members are reluctant to allow the free flow of skilled labour because of apprehension about the impact of liberalisation on domestic employment and occupational standards (Chia 2011). The situation is compounded by the fact that implementation of Mutual Recognition Arrangements has been constrained by domestic regulations (Chia 2011). For instance, regulatory barriers impede skilled labour mobility, including requirements and procedures for employment visas and passes, constitutional and legal provisions reserving jobs for nationals, economic and labour market tests that constrain employment of foreigners and require them to be replaced by locals within a stipulated period, language proficiency requirements and licensing regulations of professional bodies.
- The issue of trade facilitation remains a major obstacle for realising the AEC. There has been slow progress in harmonisation and standardisation of trade and customs procedures, customs modernisation, and integration of national single windows (NSWs) into an ASEAN single window (ASW). While ASEAN-6 has made much more progress in trade facilitation, CLMV lag far behind. There have also been delays and unevenness in implementing key reforms such as integrating NSWs into the ASW—with Cambodia, Laos and Myanmar (CLM) lagging behind, and the rest in various stages of implementation (ERIA 2012). Furthermore, private sector feedback

from several Member States continues to cite excessive and time-consuming documentation requirements, as well as irregular and arbitrary payments for expediting customs procedures (ADB 2013).

- ASEAN is divided, and the most striking divides are disparities in income, economic structure, investment and infrastructure and other human development dimensions that separate the newer members of ASEAN from the ASEAN-6 countries. Despite CLMV countries' notable achievements in economic development and catching up with ASEAN+6, the development gap within the region remains quite large. The Organisation for Economic Co-operation and Development (OECD)'s Narrowing Development Gap Indicators show that disparities between ASEAN+6 and CLMV countries are at the widest in poverty and human resource development and the narrowest in tourism and information and communications technology. Beyond these economic and social gaps, significant disparities in institutional capacity and human resources among ASEAN Member States exist. Such large development gaps are complicated by legislative and regulatory limitations and weakly coordinated implementation across national ministries and agencies.

In spite of several remaining issues, gradual liberalisation and incremental implementation of policy measures to create the AEC is an on-going process with the target completion date set for 2015. "One should not expect 2015 to see ASEAN suddenly transformed, its nature and processes abruptly changed, its members' interests substantially altered. Rather, 2015 should be viewed more as a milestone year—a measure of a work in progress—rather than as a hard target year (Das et al. 2013, pp.2)".

Assessment of Cambodia's preparatory process for AEC 2015: Overall assessment of progress and key challenges

According to the AEC Scorecard, Cambodia has done well in meeting milestones. The country's performance has been above average in meeting various indicators leading to the full implementation of the AEC. Achievements to date are attributable partly to the openness of the Cambodian economy and Cambodia's 2004

accession to the WTO that requires Cambodia to put in place rules and regulations in compliance with international trade laws (Chan and Strange 2012; Das et al. 2013). At the leadership and policy level, the Cambodian government has demonstrated its strong commitment to the realisation of the AEC by 2015. Specifically, one section of Rectangular Strategy Phase III titled "Deepening Cambodia's Integration into the Region and the World" states:

The process of Cambodia's integration into regional and global communities will deepen especially through participation in the ASEAN Economic Community to be established in 2015, while making utmost efforts to effectively harness opportunities and the conducive environment stemming from regional integration to achieve maximum benefits for Cambodia, particularly through linking the Cambodian economy to regional production networks and global value chains.

These high-level policy commitments also partly explain Cambodia's willingness and preparedness for the AEC.

In plotting its regional future, along with the many opportunities presented by AEC 2015 and broader Asian integration and cooperation, Cambodia also faces some significant challenges.

- The complex set of initiatives to promote greater economic interaction in the region pose significant challenges for the capacity of Cambodian institutions and the country's private sector (Hing and Strange 2014). Most public institutions in Cambodia are characterised by a lack of financial and human resources, uneven coordination vertically and horizontally and lack of sufficient incentives to perform tasks effectively; this is evident in the country's low score of 3.3 out of 6 in the World Bank Country Policy and Institutional Assessment.¹ Given its current level of development and institutional limitations, the complex and multi-layer regional integration processes will cause greater coordination problems for Cambodia

¹ Among the 16 indicators used as assessment criteria, Cambodia scored lowest in property rights and rule-based governance, transparency and accountability, efficiency of revenue mobilisation, and corruption.

and thus lead to less effective management of regional cooperation. For business, despite the existence of effective, national-level mechanisms for consultation between the government and the private sector, private sector engagement in ASEAN processes is at best uneven, and there is a lack of awareness about the benefits and opportunities of region-wide Free Trade Arrangements (FTAs) and of regional integration (Chan and Strange 2012).

- Cambodia has not fully reaped the benefits of regional integration. As well as the country's meagre volume of intra-ASEAN trade compared with other countries in the region, Cambodia has not been part of dynamic regional production sharing. Furthermore, the use of tariff preferences among Cambodian businesses is quite low (Fukunaga 2013). Out of 60 firms surveyed, 20 percent had applied for a certificate of origin under the ASEAN Trade in Goods Agreement scheme, 16.7 percent under the ASEAN China FTA, and 3.3 percent under the ASEAN Korea FTA. The majority of businesses cited a lack of information as the main reason for not using FTAs.
- Infrastructure development, both "hard" and "soft", does not respond well to business needs. Various studies by the Cambodia Development Resource Institute (CDRI), including CDRI (2013), Hing et al. (2013) and Hing (2013) have argued that infrastructure development in Cambodia has lagged behind that of its ASEAN neighbours. The Global Competitiveness Report 2014 ranked Cambodia's overall infrastructure at 107, with a score of 3.05—quite low compared with the average score of 4.07 for ASEAN as a whole. Road transport remains embryonic and inefficient, and the railway system is in bad shape with little traffic demand. While the effectiveness of ports has improved, the cost of shipping remains high. The power supply is costly, insufficient and to some extent unreliable, while telecommunications coverage remains limited. In addition, soft infrastructure is currently lagging behind the hard infrastructure. The World Bank Logistics Performance Index 2014 ranked the country at 83 among 160 countries, compared with

Vietnam (48) and Thailand (35). This poor performance largely stems from two major problems: first, lack of transparency in fees, often informal, hiding the true costs and making logistics expensive; second, a lack of integration of logistics services with neighbouring countries, also leading to higher costs, lack of capacity and delays (Clark and Sok 2013).

- Despite significant progress, trade facilitation performance remains poor compared to other ASEAN countries. While in Thailand it takes 14 days, in Malaysia 11 days and in Singapore five days to comply with all procedures required to export, the same process takes 22 days in Cambodia.² Business also faces other major problems: the cost of shipping remains high; the cost of an import licence is also high due to significant informal payments; and the cost of exports is worsened by delays and informal payments to obtain VAT rebates. This is confirmed by exporters' opinions cited in Hing (2013) and by the investment climate survey reported in Clarke (2014), that customs formalities including paperwork and clearance are among the top three impediments. Inefficiency in import and export processes directly affects trade costs. Latest statistics in Clarke (2014) indicate that export costs in Cambodia are 40 percent higher than the regional average.
- Cambodia's education and human capital lag behind most countries in the region, creating a major constraint on harnessing the opportunities from the AEC. The country has one of the lowest literacy rates in the world (73.9 percent in 2012), and its Human Development Index is one of the lowest in ASEAN. Moreover, the current labour market is characterised by emerging skills mismatches and skills gaps largely due to lack of motivation, staff turn-over, and insufficient education and training. On labour movement, Cambodia is a net labour exporter, but most migrants are unskilled or low skilled workers who seek/take jobs without valid documents (irregular migration) and are not covered by the AEC's free flow of labour component. This

² World Bank Doing Business. 2013. Accessed 3 January 2012. www.doingbusiness.org/rankings.

leaves Cambodian migrant workers vulnerable to abuse and human rights violations.

- SMEs in Cambodia face several major challenges including weak legal framework and bureaucracy, difficult access to finance, insufficient support, and low productivity in addition to very limited participation in regional integration (Roth 2014). Roth argues that SME development in Cambodia is still at the initial stage and not yet ready for the AEC. Similar findings are reported in ERIA (2014), that Cambodia appears to be the poor performer in all SME policy dimensions: institutional framework, access to support services, cheaper and faster start up and better regulations, access to finance, technology and technology transfer, international market expansion, promotion of entrepreneurial education and more effective representation of small enterprises' interests.

Policy priorities to leverage the AEC and greater Asian integration for economic growth

AEC 2015 provides an excellent opportunity for Cambodia in terms of economic and welfare gains as well as a platform to boost domestic reform initiatives. The AEC is expected to increase Cambodia's real GDP by 4.4 percentage points, exports by 5.3 percentage points and private investment by 24.8 percentage points (Itakura (2013). Hing and Strange (2014) argue that the AEC and broader Asian regional cooperation can promote physical connectivity, bring greater access to regional markets, resources and investments, increase involvement in regional production networks, accelerate necessary domestic reforms and thus improve the business and investment climate. Global experience suggests that trade integration has been a key to growth and development. But while economic integration is a necessary condition for growth, it is not sufficient. To sustain growth over a long period and to leverage AEC and broader regional cooperation for economic growth, Cambodia should undertake the following policy measures:

- *Maintain sound macroeconomic management:* Securing a stable and resilient macroeconomic environment will continue to be critical to

successful outcomes from regional integration. Policy priorities include maintaining low inflation and exchange rate stability, building trade sector resilience, improving revenue collection and strengthening financial sector services.

- *Improve investment climate:* Priorities to remedy investment climate weaknesses include improving infrastructure, streamlining customs procedures, enhancing logistics efficiency and investing in human capital. Also conducive to investment would be deepening special economic zones through superior infrastructure, overcoming bureaucratic and administrative hurdles, creating more flexible employment relationships and ensuring ready access to low and highly skilled labour.
- *Improve logistics and simplify customs procedures:* Cambodia is among the countries with the least efficient logistics services, which stems from insufficient and poor quality of infrastructure, low efficiency and effectiveness of clearance by customs and border control agencies, and low competence. Policy interventions can range from improved trade-related infrastructure to better border management, i.e. through reforming and modernising customs and wider information sharing, greater competition in trucking, port and airfreight services, and ready access to information about international transit agreements.
- *Invest in human capital:* Cambodia must invest heavily in skills upgrading and human capital development. Improving the education system should be the prime policy focus, with primary and secondary education imparting the necessary foundational skills to young people, and higher education and technical and vocational education and training (TVET) building on that. In particular, this would produce the highly skilled youth (especially in science, technology, engineering, and mathematics—STEM subjects) the country requires. Cambodia can benefit from the AEC since it can continue to import skilled labour from other ASEAN countries to tide it over this period of skills shortage. But over the longer term, the country should also

focus on developing the skills of domestic labour so that it can reduce its dependence on foreign skilled labour.

- *Improve export market information services:* The private sector lacks knowledge of export procedures and export markets. A short-term priority measure should be providing support needed by exporting firms, particularly in product and market development and market information services. Policy measures should also focus on building domestic trade networks (government, private sector and investors) and overseas networks (foreign governments, international buyers and investors) and improving information systems. There is also a need to raise firms' awareness about the AEC and its opportunities for investment, trade and private sector development in order to motivate deeper private sector involvement in the AEC.
- *Synchronise regional cooperation frameworks:* The country needs to improve its institutional arrangements, which have hampered integration in the past. Coordination and communication among government agencies need to be clear and efficient. Capacity building has to be provided to those who have a role in these frameworks. Central to this will be ensuring the coordination and synchronisation of GMS-ASEAN-East Asian development cooperation and regional integration to include a focus on sustained growth and bridging the development gap, with associated regional investment in long-term institutional capacity development.
- *Enhance SME development support:* Policy priorities to develop SMEs and promote their participation in the AEC include: encourage the informal sector to grow and operate formally; strengthen intra-governmental coordination on SME policy formulation and implementation; continue to reduce red-tape and improve the business climate; improve access to finance; systematically continue to build the capacity of SME owners; and encourage SMEs to go international ("learning by doing").

References

- ADB, Asian Development Bank. 2013. "Toward an ASEAN Economic Community – and Beyond." *In Asian Economic Integration Monitor—October 2013*. Mandaluyong City: Asian Development Bank.
- ASEAN Secretariat. 2012. *ASEAN Economic Community Scorecard: Charting Progress toward Regional Economic Integration; Phase I (2008-2009) and Phase II (2010-2011)*. Jakarta: ASEAN Secretariat.
- Austria, S. Myrna. 2013. "Non-Tariff Barriers: A Challenge to Achieving the ASEAN Economic Community." *In The ASEAN Economic Community: A Work in Progress*, edited by Sanchita Basu Das, Jayant Menon, Rodolfo Severino and Omkar Lal Shrestha, 31-94. Singapore: Asian Development Bank/Institute of Southeast Asian Studies.
- Chan Sophal and Larry Strange. 2012. "Achieving the AEC 2015: Challenges for Cambodia and its Businesses." *In Achieving the ASEAN Economic Community 2015: Challenges for Member Countries and Businesses*, edited by Sanchita Basu Das, 37-52. Singapore: Institute of Southeast Asian Studies.
- CDRI, Cambodia Development Research Institute. 2013. *Cambodia's Development Dynamics: Past Performance and Emerging Priorities*. Phnom Penh: Cambodia Development Resource Institute.
- Chia, Siow Yue. 2011. "Free Flow of Skilled Labour in the AEC." *In Toward a Competitive ASEAN Single Market: Sectoral Analysis*, edited by Shujiro Urata and Misu Okabe, ERIA Research Project Report No. 3, 205-279. Jakarta: Economic Research Institute for ASEAN and East Asia.
- Clark, Julian Latimer. 2014. "Cambodia: Investment Climate Assessment." Presentation at Consultation Meeting on Migration, Employment and Investment: Policy Inputs for the Formulation of Cambodia's Development Strategy, Supreme National Economic Council, Phnom Penh, 4 Aug.
- Clark, Julian Latimer, and Vannara Sok. 2013. *Getting Things Moving! Improving Cambodia's Logistics to Benefit Fully from Regional Growth*,

- Issue Sheet: Trade Development. Washington, DC: World Bank Group.
- Das, B. Sanchita, Jayant Menon, Rodolfo Severino and Omkar Lal Shrestha. 2013. *The ASEAN Economic Community: A Work in Progress*. Singapore: Asian Development Bank/Institute of Southeast Asian Studies.
- ERIA SME Research Working Group. 2014. *ASEAN SME Policy Index 2014: Towards Competitive and Innovative ASEAN SMEs*, ERIA Research Project Report 2012-8. Jakarta: Economic Research Institute for ASEAN and East Asia.
- ERIA, Economic Research Institute for ASEAN and East Asia. 2012. *Mid-Term Review of the Implementation of AEC Blueprint: Executive Summary*. Jakarta: Economic Research Institute for ASEAN and East Asia.
- Fukunaga, Yoshifumi. 2013. "How Should ASEAN Move Forward FTAs toward RCEP?" Presentation at ERIA Capacity Building Seminar 2013 in Cambodia on RCEP, Competition Law, Consumer Protection, IPR, Sofitel Phnom Penh, Phnom Penh, 31 Oct-1 Nov.
- Hing Vutha. 2013. "Cambodia and Its Region—Challenges and Choices." *Annual Development Review 2013-14*, 9-25. Phnom Penh: CDRI.
- Hing Vutha, Khieng Sothy, Lun Pide, Saing Chan Hang and Larry Strange. 2013. *ASEAN 2030: Growing Together for Economic Prosperity – The Challenges*. Phnom Penh: CDRI.
- Hing Vutha and Larry Strange. 2014. *Leveraging Trade for Economic Growth in Cambodia*. Working Paper Series No. 81. Phnom Penh: CDRI.
- Itakura, Ken. 2013. "Impact of Liberalization and Improved Connectivity and Facilitation in ASEAN for the ASEAN Economic Community." ERIA Discussion Paper 2013-01. Jakarta: Economic Research Institute for ASEAN and East Asia.
- Menon, Jayant. 2013. *Supporting the Growth and Spread of International Production Networks in Asia: How Can Trade Policy Help?* ADB Working Paper Series on Regional Economic Integration No. 112. Manila: Asian Development Bank.
- Menon, Jayant. 2012. *Narrowing the Development Divide in ASEAN: The Role of Policy*. Manila: Asian Development Bank.
- Nikomborirak, Deunden, and Supunnavadee Jitdumrong. 2013. "Non-Tariff Barriers: ASEAN Trade in Services." In *The ASEAN Economic Community: A Work in Progress*, edited by Sanchita Basu Das, Jayant Menon, Rodolfo Severino and Omkar Lal Shrestha, 95-140. Singapore: Asian Development Bank / Institute of Southeast Asian Studies.
- Roth Vathana. 2014. *SMEs in Cambodia: Policy Options and Remaining Challenges*. Presentation at Development Research Forum Research Workshop on Understanding SME Policy Environment in ASEAN, Phnom Penh Hotel, Phnom Penh, 2 June.
- Severino, Rodolfo, and Jayant Menon. 2013. "The ASEAN Economic Community: An Overview." In *The ASEAN Economic Community: A Work in Progress*, edited by Sanchita Basu Das, Jayant Menon, Rodolfo Severino and Omkar Lal Shrestha, 1-300. Singapore: Asian Development Bank/Institute of Southeast Asian Studies.
- Wermelinger, Martin. 2011. *Features of Post-Crisis Protectionism in Asia and the Pacific*. ARTNet Working Paper Series, No. 97. Bangkok: ARTNet.
- Wong, Marn-Heong, and Andre Wirjo. 2013. *Findings from 2013 ASEAN-BAC Survey on ASEAN Competitiveness*. Jakarta: ASEAN Business Advisory Council.
- WTO. World Trade Organization. 2011. *The WTO and Preferential Trade Agreements*. World Trade Report 2011 Geneva: WTO.

List of abbreviations

AEC	ASEAN Economic Community
ASEAN	Association of Southeast Asian Nations
ASW	ASEAN Single Window
CLMV	Cambodia, Laos, Myanmar and Vietnam
FTAs	Free Trade Arrangements
GDP	Gross Domestic Product
GMS	Greater Mekong Subregion
NSWs	National Single Windows
OECD	Organisation for Economic Co-operation and Development
SME	Small and Medium Enterprise
TVET	Technical and Vocational Education and Training

About DRF

The Development Research Forum (DRF) of Cambodia was established following the All-Partners Forum organised by the International Development Research Centre (IDRC) in September 2007.

The DRF vision is of a high capacity, professional and vibrant Cambodian development research community. Its goal is to support and strengthen the capacity of the Cambodian development research community.

The DRF partnership involves the Cambodia Development Resource Institute (CDRI), Cambodian Economic Association (CEA), Learning Institute (LI), National Institute of Public Health (NIPH), Royal University of Agriculture (RUA), Royal University of Phnom Penh (RUPP), Supreme National Economic Council (SNEC) and the International Development Research Centre (IDRC).

In DRF Phase II 2012-15, with financial support from IDRC, the partners intend to work together to build research culture and capacity and to share research knowledge through workshops, policy roundtables and symposiums as well as training and online discussion (www.drfcambodia.net) on six research themes: growth and inclusiveness, governance of natural resources, social policy – education, social policy – health, agricultural development, and Cambodia and its region.

A Partnership of



ឧត្តមក្រុមប្រឹក្សាសេដ្ឋកិច្ចជាតិ
Supreme National Economic Council



Canada

The responsibility for opinions expressed in signed articles, studies and other contributions rests solely with their authors, and publication does not necessarily constitute an endorsement by CDRI.

CDRI – Cambodia's leading independent development policy research institute

☎ 56 Street 315, Tuol Kork ☒ PO Box 622, Phnom Penh, Cambodia

☎ (855-23) 881384/881701/881916/883603 ☎ (855-23) 880734

Email: cdri@cdri.org.kh, Website: www.cdri.org.kh