

Chapter 1

Introduction

CHAPTER 1 INTRODUCTION

1.1 BACKGROUND

Poverty alleviation is one of the most important targets of the development policies in Cambodia. This policy can be achieved by providing direct public services to the poor and stimulating growth of the economy to absorb the increasing young labor force. In this context, a proposal of the regional development master plan is expected to indicate the direction of industry development for the potential corridor area.

In response to a request from the Royal Government of the Kingdom of Cambodia (hereinafter referred to as “RGC”), the Government of Japan (hereinafter referred to as “GOJ”) decided to conduct the Study on Regional Development of the Phnom Penh – Sihanoukville Growth Corridor in the Royal Kingdom of Cambodia (hereinafter referred to as “the Study”) in accordance with the relevant laws and regulations in force in Japan.

Accordingly, the Japan International Cooperation Agency (hereinafter referred to as “JICA”), the official agency responsible for the implementation of the technical cooperation programs of the GOJ, has undertaken the Study in close cooperation with the related authorities of the RGC.

1.2 STUDY FRAMEWORK

1.2.1 Objective

The objectives of the Study, as stated in the Scope of Work agreed on by the Ministry of Commerce and JICA on the 4th of October 2001 are:

- (1) Formulating a master plan on regional development of the Phnom Penh –Sihanoukville Growth Corridor, mainly focused on industry development for the target year of 2015,
- (2) Conducting a feasibility study on the Sihanoukville Export Processing Zone (EPZ), which has been proposed as one of the key factors for corridor development, and,
- (3) Providing proper technology transfer, in order to incubate the talents of related counterpart staff and to foster Cambodian ownership for the plan/project implementation, throughout the course of the Study.

1.2.2 Study Area

The Study Area for the Phnom Penh – Sihanoukville Corridor is the area adjacent to National Highways No. 3 and No. 4. Two municipalities (Phnom Penh and Sihanoukville) and five provinces (Kampong Spueu, Kampot, Takaev, Kandal and Kaoh Kong) are represented over the extent of the corridor (**Figure 1-1**).

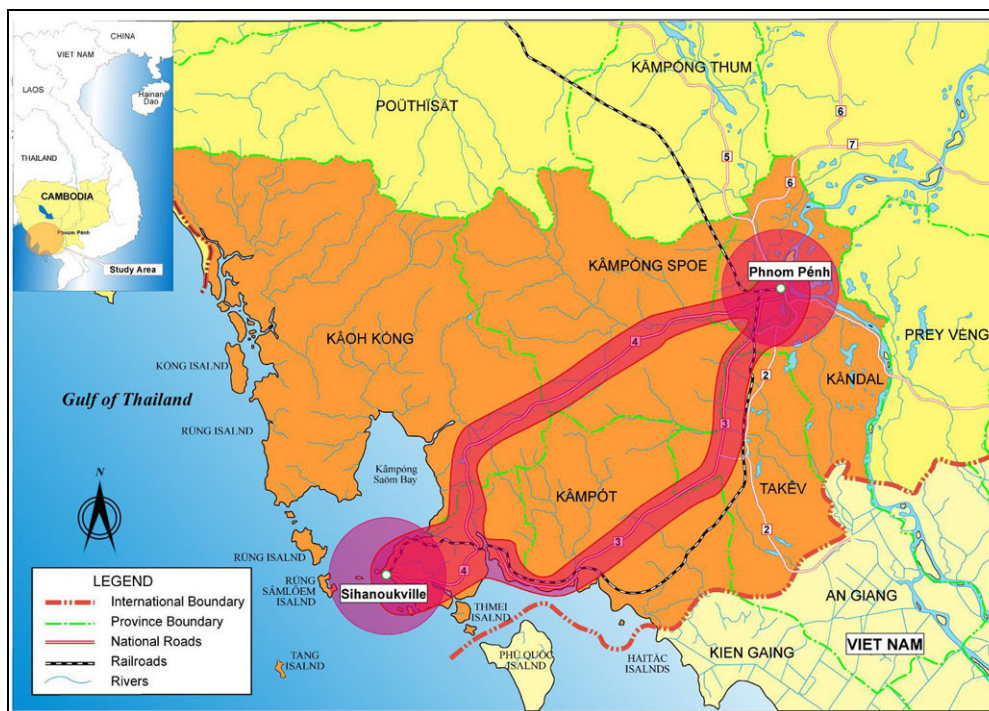


Figure 1-1 Study Area

1.2.3 Role of the Study

The Study Area has been providing the strength of economic development in Cambodia, and is expected to be a major growth axis for the Cambodian economy in the future. The Corridor stretches between the national capital city of Phnom Penh and the seaport in Sihanoukville. Given these geo-economic characteristics of the area, it is quite likely that the Corridor is one of the best places to accommodate various industrial developments in the country. The role of the Study is to present ideas to realize the potential of the Corridor to a maximal extent.

1.2.4 Development goals of the Study

Preliminary development goals are set as follows;

- Promotion of FDI and export oriented industries by improving investment environments including the development of SPZ.
- Creating employment opportunities for the younger generation
- Providing opportunity for human resources development through new employment and auxiliary training
- Promotion of support for local industries along the Corridor.

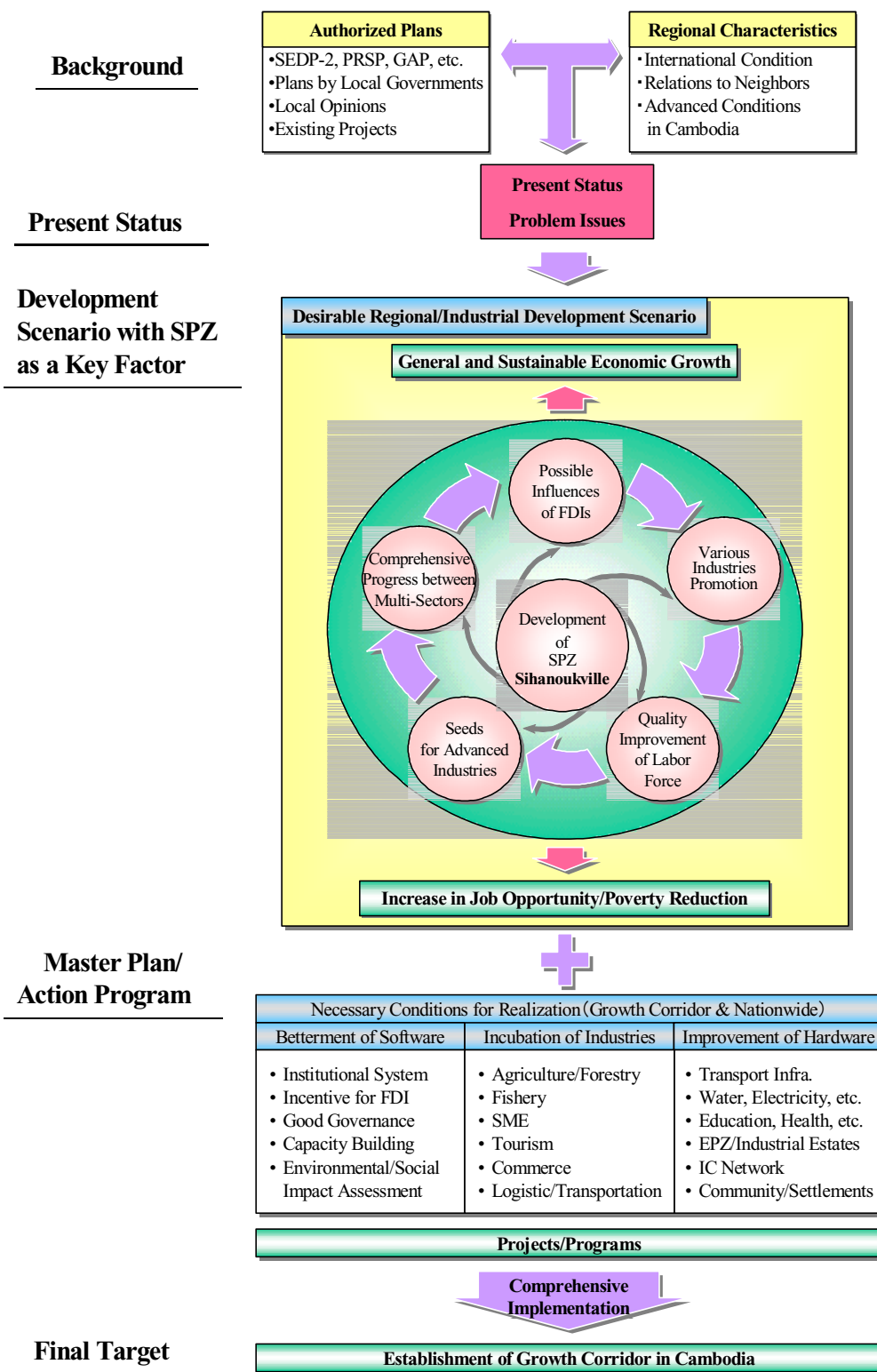
In the process of the Study, it is also intended to contribute to the capacity building of the government officials concerned through their participation in planning exercises.

1.2.5 Target years of the master plan

The mid-term and long-term target years of the Master Plan are 2008 and 2015 respectively, with specific reference to the given timeframe of the AFTA¹ agreement. It is agreed that tariff rates will be reduced to less than 5% in 2008, and then further to 0% in 2015 within ASEAN countries. In addition, the urgent-term is set at 2005, when the existing quotas for Cambodian garment export will expire.

A schematic concept of the Study can be illustrated as in **Figure 1-2**.

¹ AFTA stands for ASEAN Free Trade Area.



SPZ: Special Promotion Zone

Figure 1-2 Overall Concept of the Study

1.3 GENERAL APPROACH OF THE STUDY

The Study Team places an emphasis on the following approaches for the implementation of the Study.

1.3.1 An Issue-Based Approach

The Study Team addressed the industrial development in Cambodia as the central issue, focusing on the promotion of diversifying the export-oriented industries. As the industrial accumulation of Cambodia is generally low and is not adequate to generate export processing firms, primarily foreign firms run by FDI will have to play a key role in the short run. Domestic enterprises as receptors of effects by locating export processing firms will have an increasingly important role for the Cambodian economy, and will have to be mainstreamed in the medium to long terms.

This Study will address various issues related to the industrial develop, by examining the factors and problems hindering the promotion of industrial development on a multi-sector format..

1.3.2 Multi-Sector Coherence Approach

The study team consisted of 16 experts with various expertise and background. The regional development master plan was a primary product in the earlier phase. Each sector plan carefully examined the issues related to the industrial development from the sector perspective. As the Study is issue-based, the sector plan in this Study primarily addresses the sector issues related to the industrial development, and may not necessarily present a comprehensive sector plan.

As the issue of promoting the export oriented industries is wide spread and multi-faceted, strong policy coherence among the relevant ministries and agencies is imperative. This Study aims to promote this policy coherence.

1.3.3 A Process-Oriented, Cooperative Approach

The Study Team conducted many types of interactions with stakeholders. The Study Team and the Counterpart Group held five seminars in the course of the Study to facilitate dialogue among the various stakeholders on the findings and proposals in this Study. In addition, the study team opened a homepage on the Internet to provide information and facilitate close communicate with stakeholders.

The Study Team treasures the Cambodian ownership for this project, because most of the proposals and recommendations of this Study will only be materialized by to the Cambodian counterparts. To foster Cambodian ownership, the Study Team worked closely with the counterpart personnel. Input from the counterpart personnel greatly broadened the contents of the Study and gave much substance to the conclusions and recommendations of this Study.

Chapter 2

Inter Regional Issues

CHAPTER 2 INTER REGIONAL ISSUES

2.1 POSITION OF THE GROWTH CORRIDOR IN THE WIDER CONTEXT

2.1.1 Integration of Indochina

(1) Integration of the Indochina Economy

There are clear initiatives to integrate the economies of the Indochina countries. In the short to medium terms, there is a manifest target in Indochina for better and closer links for Cambodia with the economies of Thailand and Vietnam. These two countries are the mainstays of the Indochina economy both in terms of the population and economic activity. Major socioeconomic indicators of Vietnam and Thailand in comparison with Cambodia are summarized in the following **Table 2-1**. Cambodia is the smallest of the three in terms of area (181km²), population (12million) and the least developed with a per capita GDP of the US\$270. The essential development issue is apparently to catch up with the preceding neighbors and establish self-motivated development.

Table 2-1 People, Land, and Economy of Cambodia, Thailand, and Vietnam

Comparative Indicators in 2000	Cambodia	Vietnam	Thailand
People			
Population, total (millions)	12	78.5	60.7
Population growth (annual %)	2.2	1.3	0.8
National poverty rate (% of population, latest available)	36	37	16
Life expectancy at birth (years)	53.8	69.1	68.8
Illiteracy rate, adult male (% of males 15+)	20.2	4.5	2.9
Illiteracy rate, adult female (% of females 15+)	42.9	8.6	6.1
Land			
Surface area (000 sq. km)	181	332	513
Population density (persons/ sq km)	66	237	118
Economy			
GDP (current billion \$)	3.2	31.3	122.2
GDP growth (annual %)	5	5.5	4.3
GDP per capita, Atlas method (current US\$)	270	400	2,010
Agriculture, value added (% of GDP)	37.1	24.3	10.5
Industry, value added (% of GDP)	20.5	36.6	40.1
Services, etc., value added (% of GDP)	42.4	39.1	49.5
Gross capital formation (% of GDP)	15	27.4	22.7

Sources:

World Bank *World Development Indicators database*, April 2002.

ADB, *Key Indicators 2001*.

*For Cambodia, NIS, *Statistical Yearbook of Cambodia 2001*.

In Indochina, there are three major international centers; the metropolitan areas of Bangkok, Ho Chi Minh City, and Hanoi, where population and economic activities are highly concentrated as shown in **Figure 2-1**. The backbone structure of the integrated Indochina economy shall be the links between these metropolitan areas that boil down to two international trunk links; the Bangkok - Ho Chi Minh City link and the Bangkok - Hanoi link. For Cambodia, the Bangkok - Ho Chi Minh link that crosses right through the middle of the country shall clearly have a crucial impact on

its economy as shown in **Figure 2-2**. The development of Cambodia will naturally depend on close linkage and complementary function within these urban contents.

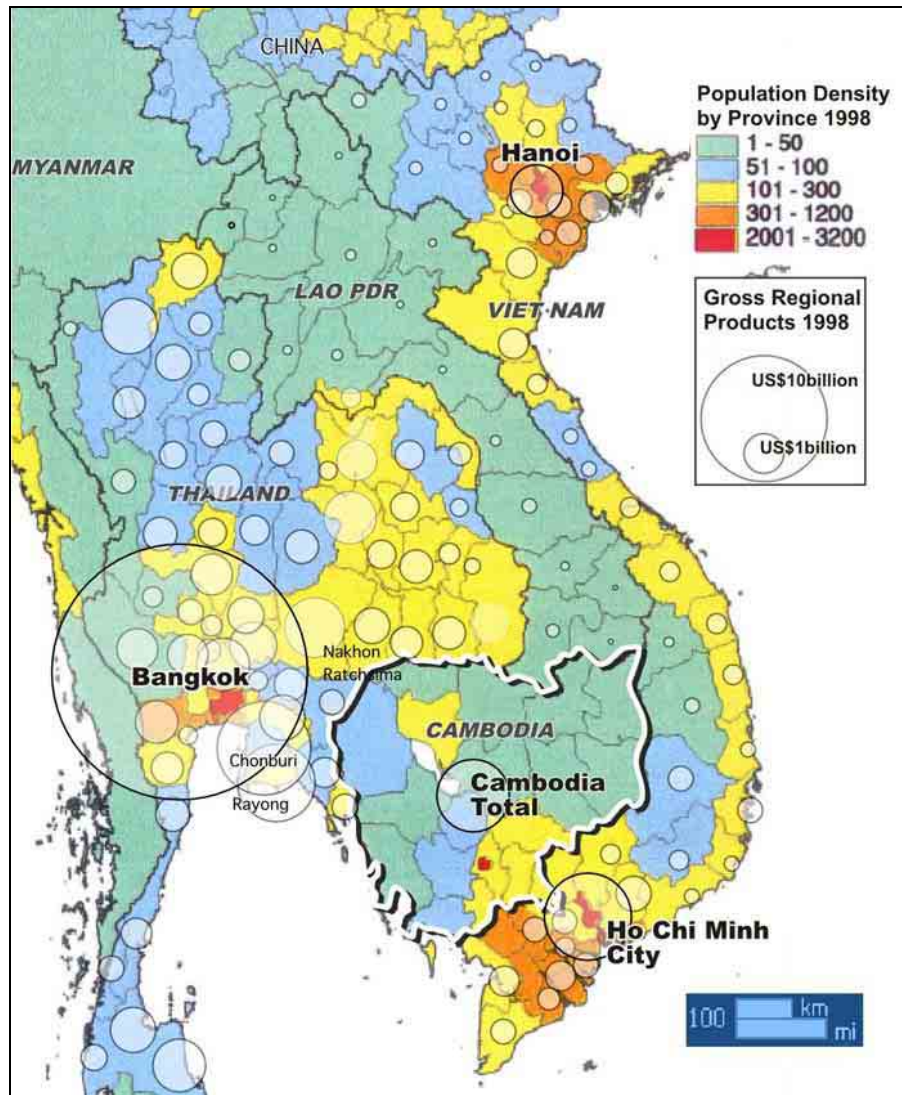


Figure 2-1 Distribution of Population and Economic Activities in Indochina



Figure 2-2 The Backbone Structure: Three Metropolitan Areas and International Link

There are two major international initiatives that are intended to promote the trends for the Indochina integration as follows.

- Greater Mekong Sub-region (GMS) Program: focusing on international infrastructure development.
- ASEAN Free Trade Area (AFTA): focusing on removal of non-physical trade barriers within ASEAN nations.

Outlines of GMS and AFTA are summarized in the following sections. The implications of these initiatives on the development strategy of the growth corridor area will be discussed in **Chapter 5**.

(2) The GMS Program

Overview

The Greater Mekong Sub-region (GMS) Program is a major existing international initiative that promotes integration of the Indochina nations into one regional economy. GMS comprises Cambodia, Lao People's Democratic Republic, Myanmar, Thailand, Vietnam and Yunnan Province in the People's Republic of China.

The GMS program includes the following major contents.

- Better linkage among the 6 intra-sub regional countries by developing a network of transportation, telecommunication, and energy.
- Better network for realizing a functional sub-regional market both in terms of trade and investment.
- Better chance for policy dialogue among the sub-region countries, especially with regard to issues related to international infrastructure management, labor movement, and trade and investment rules and regulations.

The GMS Economic Cooperation Program was initiated in 1992, with the assistance of the Asian Development Bank (ADB). An ADB study team visited the six countries that year to assess the potential for sub regional cooperation and to identify the areas where specific cooperation initiatives could play an important role. Sector studies were subsequently conducted, which became the basis for the identification of sub regional projects. A number of these sub regional initiatives have now entered the implementation stage. Approved ADB-financed GMS loan projects are as shown in **Table 2-2**.

Table 2-2 ADB financed GMS Loan Projects

COUNTRY	PROJECT NAME	APPROVED DATE	LOAN AMOUNT (\$ million)
PRC	Yunnan Expressway	29-Sep-94	150.0
Lao PDR	Theun Hinboun Hydropower	8-Nov-94	60.0
Lao PDR	Champassak Road Improvement	31-Aug-95	48.0
Lao PDR	Nam Leuk Hydropower Development	10-Sep-96	52.0
Cambodia	Siem Reap Airport	12-Dec-96	15.0
PRC	Southern Yunnan Road Development	24-Jun-99	250.0
Cambodia	Phnom Penh-Ho Chi Minh City Highway	15-Dec-98	40.0
Viet Nam	Phnom Penh- Ho Chi Minh City Highway	15-Dec-98	100.0
Lao PDR	East-West Corridor Project	20-Dec-99	32.0
Viet Nam	East-West Corridor Project	20-Dec-99	25.0
TOTAL			772.0

Source: ADB, A Wealth of Opportunity, Development Challenges in the Mekong Region.

To ensure effective project implementation and to sustain overall cooperation, the six countries established an institutional mechanism as part of the GMS Program. Working groups and forums have been set up to discuss and recommend approaches to issues affecting both the "hardware" and "software" aspects of the implementation. A ministerial body was established to coordinate sub regional cooperation and provides overall policy guidance and support. A National Coordinating Committee in each country coordinates participation in GMS activities. Consistent with its

facilitating role, ADB has been providing technical, administrative and logistical support to these forums and working groups.

Economic Corridors under the GMS Program

The most important feature of the GMS Program is the provision of spatial frameworks for the international corridor system stretching over the national boundaries. ADB defines "an economic corridor" as follows:

"An economic corridor is a well defined area where infrastructure improvements are linked with production, trade and other development opportunity in order to promote economic development and cooperation among contiguous regions or countries".

This concept of a "corridor" follows an holistic approach to integrate various development and cooperation projects within the defined belts of areas. A corridor includes roads, railways, power transmission lines and optic fiber cables, and etc.

The GMS Program identified the following four economic corridors as the focal areas of cooperation, as shown in **Figure 2-3**.

- East-West Economic Corridor
- Bangkok - Phnom Penh - Ho Chi Minh City Corridor (Southern Economic Corridor)
- Kunming - Chiang Rai Corridor
- Kunming - Hanoi - Haiphong Corridor

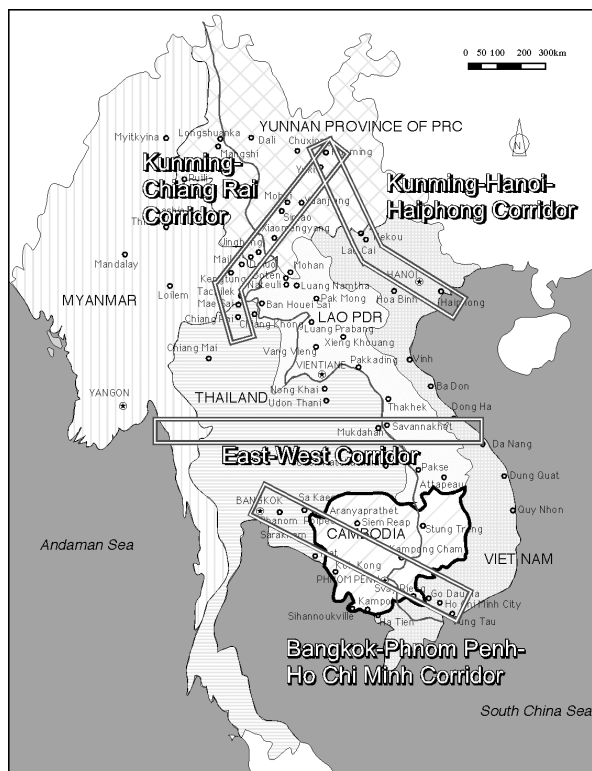


Figure 2-3 GMS Countries and Defined Economic Corridors

All corridors have a similar combination of infrastructure projects. Among these four, the East-West Corridor has already been activated as a pilot project. The other three corridors are classified as "second tier" and are waiting for implementation.

(3) ASEAN Free Trade Area (AFTA)

The ASEAN countries signed the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area (AFTA) in 1992. Currently, the CEPT includes more than 96,000 items, equivalent to more than 90% of all commodities traded between the countries. "Free Trade" will be realized by lowering or eliminating the tariff rates on CEPT items. On the other hand, the member countries can also protect their domestic agricultural sector by listing competitive agricultural products on its own "Sensitive List" or "Highly Sensitive List." These lists are scheduled to phase into the current CEPT scheme by the year of 2015.

AFTA will not only liberalize commodity trade but also promote investment from ASEAN and other countries by the AIA (ASEAN Investment Area) scheme. Especially investment to following seven areas will be given higher priorities: (1) tourism, (2) telecommunication, (3) air transportation, (4) sea transportation, (5) business, (6) finance and (7) construction.

Table 2-3 shows the GMS nations and two international trade affiliations, namely AFTA and WTO. The position of Yunnan Province (China) is an exception among GMS countries, as China does not belong to ASEAN, and thus is not affiliated with AFTA.

Table 2-3 GMS Countries and International Trade Affiliations

Country	GMS	ASEAN	Trade liberalization under AFTA	WTO
			CEPT Items	
Thailand	Member	Member	2003	Member
Lao PDR	Member	Member	2008	Accession in process
Viet Nam	Member	Member	2008	Accession in process
Cambodia	Member	Member	2008	Accession in process
Myanmar	Member	Member	2008	Member
Yunnan (China)	Member	NA	NA	Member

Source: ADB, WTO and ASEAN

The overall implications of AFTA are summarized as follows:

- AFTA will boost intra-ASEAN trade. By its nature, AFTA is a major effort to keep competitive edges of ASEAN over China as attractive destinations for foreign (non-ASEAN) investors by making ASEAN as one contiguous free-trade economy comparable to China that became a member of WTO in November 2001.
- AFTA will boost intra-ASEAN investment. In addition to trade, AFTA includes promotion of investment and provision of services. Existing non-ASEAN

investors can easily move from one country to an other within AFTA.

- Singapore and Malaysia shall further enhance their position as investors within ASEAN. Thailand is also following them as its economy recovers from the "1997 Crisis" and AFTA progresses.
- On the other hand there is a risk that trade may be diverted from the most efficient suppliers in non-member countries by less efficient producers in member countries, if the discriminatory nature of regional integration is intensified.

2.1.2 Infrastructure Development in and Around Cambodia

This section reviews the progress of ongoing infrastructure projects in Cambodia.

(1) Road Development

The road connecting Bangkok, Phnom Penh and Ho Chi Minh is denoted as "A-1" under the Asian Highway Project. ADB calls the areas along the route the Southern Economic Corridor.

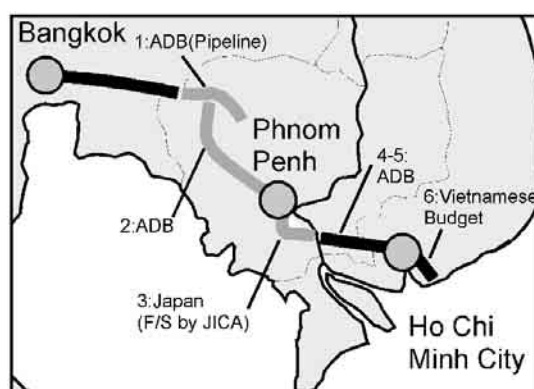


Figure 2-4 Road Development Status along the Southern Economic Corridor

Table 2-4 Road Development Status along the Southern Economic Corridor

No.	Country	Name	Location	Length (km)	Donor	Amount	Status	To be completed in
1	Cambodia	National Road 5 and 6	Poipet - Siem Reap	150	ADB	\$45mil.	Pre-approval.	To start in 2003.
2	Cambodia	National Road 5	Sisopong-Phnom Penh	362	ADB etc.		Under Construction.	
3	Cambodia	National Road 1	Phnom Penh - Neak Loeng	62	JICA		Feasibility Study ongoing	
4	Cambodia	Phnom Penh - Ho Chi Minh Highway	Neak Loeng - Bavet	105	ADB	\$40mil.	Under Construction	2003
5	Viet Nam	Highway		138		\$100mil.	Under Construction	2003
6	Viet Nam	National Road 51	Ho Chi Minh - Vung Tau	97	Domestic Budget	n.a.	Completed.	Completed in 2000.

Note: Numbers in the first column are shown in Figure

Source: MPWT, ADB and JICA Study Team

Although the entire route will not be completed for somewhere between ten and fifty years, the section between Phnom Penh and Ho Chi Minh is scheduled for an earlier completion, except for a bridge over the Mekong at Neak Loeng.

(2) Ocean Transportation

Currently, the Sihanoukville Port is the only seaport in operation in Cambodia. With a Japan Bank for International Cooperation (JBIC) loan, the Sihanoukville port has an additional 240m berth (9.50 m depth) under construction with a target of completion in 2004. Additionally, introduction of two sets of gantry cranes and two sets of transfer cranes is in preparation. This will improve the attractiveness of the Port.

Internationally, there are several large ports such as Hong Kong and Singapore, both of which are important in container handling capacity, as shown in **Figure 2-5**.

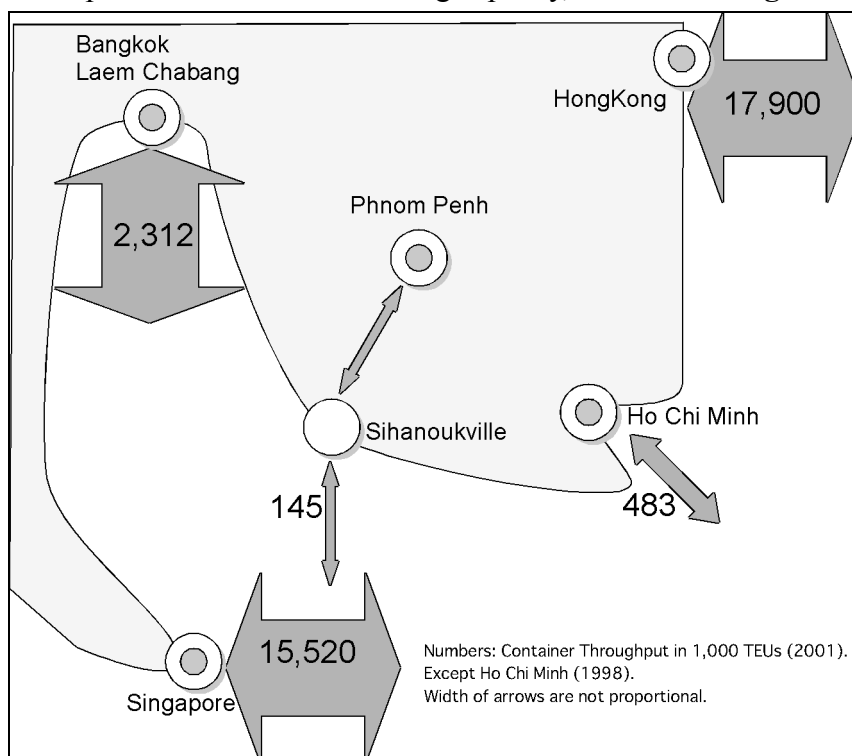


Figure 2-5 Seaports around Sihanoukville

Ocean container transportation is an important means for exporting products from Cambodia. Although most exported cargoes go to the EU or USA, the container liners (150-250 TEUs) from Sihanoukville go to Bangkok, Hong Kong and Singapore for transshipment.

As the number of exported containers grows, larger vessels (ex. 1,000 TEUs) will have to call at the Sihanoukville Port. This will be beneficial in reducing the transportation cost.

At the same time, more than 90% of the containers loaded and unloaded at the Sihanoukville Port are carried to and from Phnom Penh on Route 4. This is also an additional cost factor for container transportation. Due to the cost factors above, the

container exporting cost from Cambodia to Japan (at Yokohama) is substantially higher than that from Bangkok as summarized in **Table 2-5**.

Table 2-5 Container Shipping Charge Comparison

From	To	Tariff (US\$)
Phnom Penh	Yokohama	1,800
Sihanoukville	Yokohama	1,600
Bangkok	Yokohama	1,350
Ho Chi Minh	Yokohama	1,500

Note: 40 ft container CY to CY.

Source: JETRO and JICA Study Team

The table also shows that transportation to Yokohama from Phnom Penh costs US\$200/container more than from Sihanoukville. The implication is that is great advantage for new factories of export-oriented industries to locate not in Phnom Penh but in Sihanoukville to lower transportation cost.

(3) Air Transportation

Linkage by air transportation is becoming more important than ever in Asian countries. Asian airports are competing against one another to establish the status of an international hub airport. Since the late 90s, new airports have been developed to accommodate the growing international passenger demand in Asia.

The Bangkok International Airport (Don Muang Airport) is one of the most important hub airports in the Southeastern Asia. The scheduled completion of the New Bangkok International Airport (Nong Ngu Hao Airport) around 2005 will strengthen the footing of the Bangkok region as an international air hub. At the same time, the new Hong Kong Airport at Chek Lap Kok, opened in 1998 is establishing itself as a gateway to China.

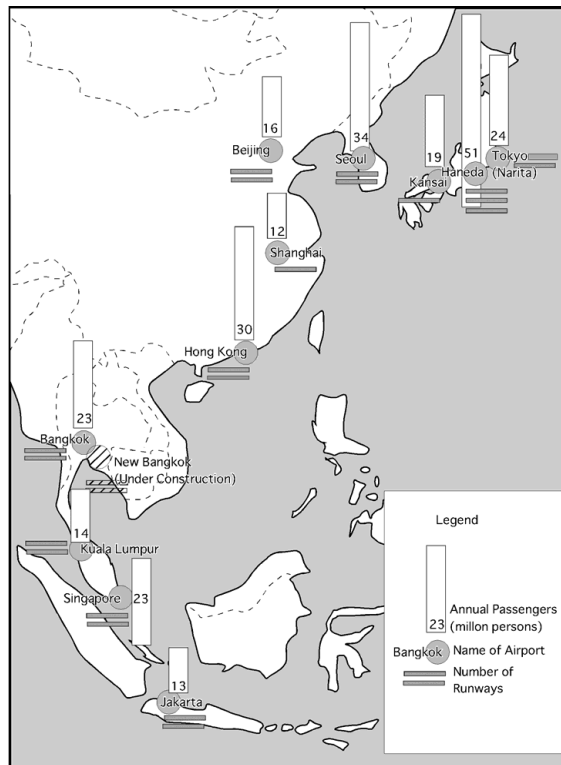


Figure 2-6 Hub Airports in Asia,



Figure 2-7 Flight Route with Cambodia

Cambodia has two major international airports; the Pochentong Airport in Phnom Penh and the Siem Reab Airport. Both airports are attracting international passengers. The Growth Corridor also holds the Sihanoukville Airport, but it does not have scheduled flights at present (See also sector report). **Figure 2-7** and **Table 2-6** show that direct international connections from Cambodia to Asian countries are limited, of which the strongest linkage is with Bangkok.

Table 2-6 International Air Passengers by Flight Route (2001)

Country	Thailand		Vietnam	Malaysia	Singapore	LaoPDR
Airport	Bangkok	Utapao	Ho Chi Minh	Kuala Lumpur	Singapore	Vientiane
Pochentong (Phnom Penh)	283,531	5,573	104,157	65,229	96,543	4,647
Sie Reab	173,618	0	75,094	0	17,946	1,324
Total	457,149	5,573	179,251	65,229	114,489	5,971

Country	Taiwan	China				Total
Airport	Taipei	Hong Kong	Tianjin	Guangzhou	Pudong, Shanghai	
Pochentong (Phnom Penh)	31,144	62,413	786	28,987	9,184	692,194
Sie Reab	0	2,221	0	0	0	270,203
Total	31,144	64,634	786	28,987	9,184	962,397

Note: Including both ways. Source: SSCA.

These numbers and routes show the following regarding Cambodia's position in the international aviation network:

- There is no direct flight with Japan, EU or USA. Because Los Angeles is out of the range of direct flight by a Boeing 747, it is physically impossible to connect without a stopover even if there was sufficient passenger demand.
- Bangkok International Airport is the most important gateway for passengers without a direct connection route.
- There is a growing demand for new routes to China.

In order to broaden the international air connections, it is necessary to attract direct flights from Japan and EU to the Pochentong International Airport in Phnom Penh. Additional linkage between the Sihanoukville Airport and Bangkok could have a substantial impact on the Growth Corridor area.

(4) Railways

The current role of the railways is somewhat limited in Indochina's countries. Considering the growing future trade with China, which has a highly developed railway system, however, the role of the railways may well have an increased importance. On its southern border the Chinese railways currently only connect to Vietnam. On the other hand, the railways from Singapore terminate at the rail network in Thailand. The railway projects under the GMS program are intended to connect these two isolated networks into one piece. There are several preliminary routes crossing Cambodia. An improved rail connection in the region may promote cargo transportation on a broad network between China and Indochina.

There are two missing sections, one on each side, which will be needed to connect the existing Cambodian railways to those in Thailand and Vietnam. Building new lines would only be possible with foreign assistance. In addition, the role of railways will be transformed from current domestic one to more international one.

The Growth Corridor region has a railway between Sihanoukville and Phnom Penh. If the railway is connected with adjacent countries, the role of the railway will be significantly changed. At the same time, the railway facilities should be significantly improved to meet the international standards.

(5) Power Supply

Electricity is one of the most traded "items" among the GMS countries. Vietnam and Thailand sell electricity to central Lao PDR. At the same time, Lao PDR sells power from its north to Northeast Thailand. Several hydropower projects in Lao PDR, such as Nam Theun 2 and Nam Ngum 2-4, will multiply the annual generated energy from 3,677 to 18,570 GWh by 2010 when the projects are completed on schedule. It is assumed that the additional energy will mainly be consumed in Thailand and Vietnam.

In general, a stable supply of electricity is a "must" for most foreign investors. Cambodia does not meet this requirement yet. Many of the existing factories depend upon their own independent power generators. Given a limited investment capacity, one of the options for Cambodia is to import power for the time being. There is a plan to connect the power grids of Cambodia with Vietnam through Takaev, in the southern part.

2.2 FUTURE PERSPECTIVES AND PLANNING IMPLICATIONS

2.2.1 Future Inland Network in Indochina

As discussed in the previous sections, the four international corridors defined in the GMS Program have an important role to connect economic centers within the GMS region. In short, the most immediate need is to formulate a network between the Thai and the Vietnamese economies. In this sense, the notion of an East-West Corridor (EWC) is not limited to a single corridor along the Second Mekong Bridge and Route 9 towards the port of Danang but rather a set of growing network of inland transportation between Thailand, Lao PDR, Cambodia and Vietnam. With these more immediate functions of the GMS Program in mind, the various on-going road developments can be thought of as an enhancement in growing the inland network as shown in **Figure 2-8**.



Figure 2-8 Conceptual Image of Inland Network in Indochina

When this inland transportation network is finally in place, Cambodia will be at the crossroads in the southern part of the network (shown in red arrows), where the two largest economic centers, Bangkok and Ho Chi Minh City, are to be linked. For Cambodia, this will have the physical effect of improving market access to Vietnam and Thailand.

If the inland network can be improved as described above, the following effects shall accrue;

(1) Export Diversification:

The improved inland link will provide important opportunities for Cambodia to diversify exports. As described in the sections on international trade, more than 70% of garment exports are delivered to EU and US markets. These exports are largely driven by agreements with the US and the EU providing MFN status and preferential access under the GSP since 1997. This preferential access, however, is to be phased out in 2005.

Thus, Cambodia will face a set of challenges to make existing garment exporters competitive against all other suppliers, and to diversify exports both in terms of directions (markets) and goods for export in the medium to long terms. Better inland links to Thai and Vietnamese markets shall promote the diversification option.

These markets have been major destinations for local resource based products of Cambodia such as wood products and processed food.

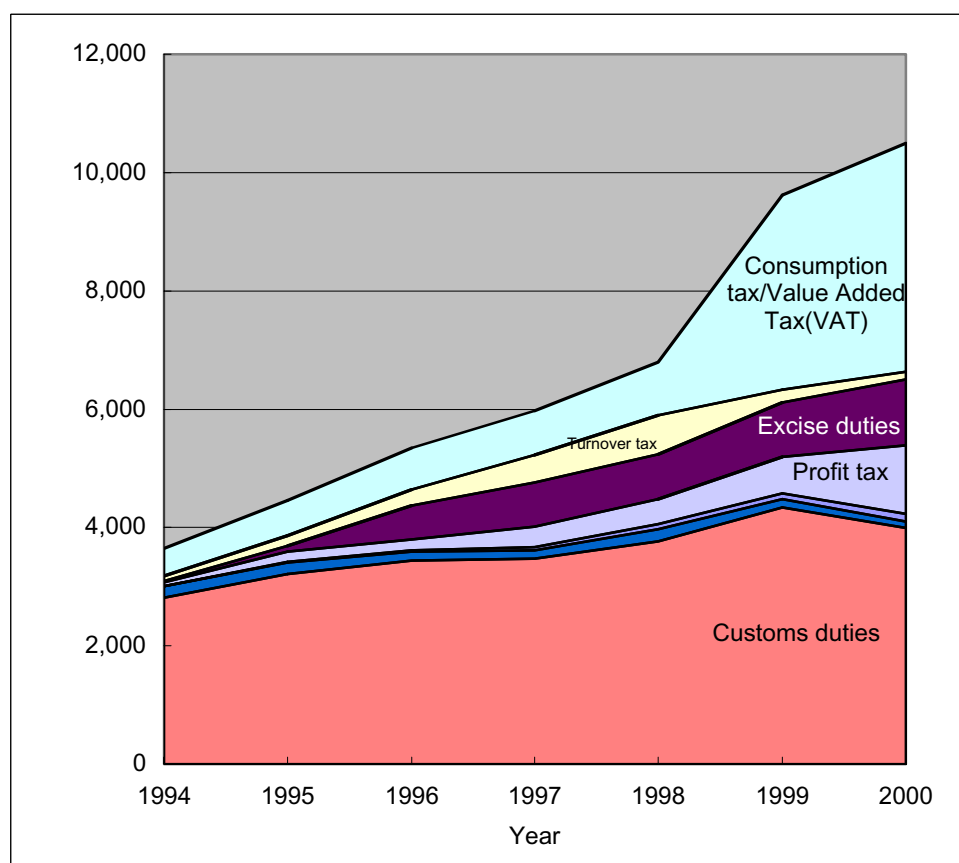
(2) Better Investment Platform in Indochina:

Given the limited size of the Cambodian economy, its domestic market alone is not attractive enough for foreign direct investors to mobilize. Investors need to think that they have good access to neighboring markets as well as the Cambodian market. Improved inland links will make Cambodia a more attractive platform for investment through which to reach the Indochina market as a whole.

2.2.2 Implications and Impacts to Cambodia Brought by Entry into AFTA

Affiliation with AFTA will have the following implications and impacts:

- Affiliation with AFTA shall require Cambodia to strengthen tax bases other than Customs duties. The introduction of a Value Added Tax (VAT) in 1999 was a major move in this line. The share of trade tax revenues in the total government revenue was decreased from 41% in 1998 to 28% in 2000. This move should be further strengthened to facilitate AFTA.



Source: NIS, Statistical Yearbook 2001 data

Figure 2-9 Tax Revenue Structure of Cambodia

- It is projected¹ that better market access to other ASEAN countries through AFTA will be likely to improve terms-of-trade for existing exports such as processed food, rubber, and wood that have been the main export commodities to ASEAN markets. Labor-intensive manufacturing commodities may also have potential. The key presumption of the model is that trade liberalization is assumed to result in a depreciation of the real exchange rate and thereby strengthen incentives to promote exports.
- AFTA will change the approach of comparative advantage among ASEAN members from "control and incentives-based" to "open-market-based". In the "control and incentives-based" approach, a government intervenes in all trades and some "freedom" is approved as privileged incentives. In the "open-market-based" approach, total costs of production and risk factors are the key determinants for investment. Any unnecessary government intervention, either explicit or implicit, is considered to be a risk factor.
- Thus, Cambodia will soon be required to eliminate risk factors and create new advantages to keep the existing garment exporters competitive under the "open market" approach.
- In the medium to long-term, exports should be diversified capitalizing on local resource base and better access to the ASEAN market. As shown in **Table 2-7**, demands for wood and rubber related products were high among the ASEAN countries linked by sea. This may relate to future prospects for the port development. For land-linked neighbors, on the other hand, in addition to the wood products, demand for processed food was sizable. Agro-processed products may have prospective markets, such as Thailand and Vietnam, since they are usually transported over land routes.

1 Fukase and Martin, Free Trade Area Membership as a Stepping Stone to Development - The Case of ASEAN, World Bank Discussion Paper No. 421, February 2001.

Table 2-7 Cambodia's Destination for Exports 1998

(Million of Riels)

Trade Affiliation	ASEAN/AFTA											
	By Overseas Network						By Inland Network					
	Singapore	Malaysia	Philippines	Indonesia	Total	% Share	Thailand	Vietnam	Total	% Share	Total	% Share
Wood products & paper	421,141	0	0	4	421,145	78.6	260,472	58.5	260,472	58.5	681,617	69.5
Rubber	61,827	11,470	0	0	73,297	13.7	0	10,806	10,806	2.4	84,103	8.6
Wood	295	7,352	11,432	18	19,097	3.6	23,910	14,022	37,932	8.5	57,029	5.8
Electrical and Mechanical machines	1,580	2,149	0	2,043	5,772	1.1	715	1,192	1,907	0.4	7,679	0.8
Textiles	3,999	148	0	67	4,214	0.8	298	100	398	0.1	4,612	0.5
Processed foods, drinks & tobacco	2,399	141	845	0	3,385	0.6	586	121,718	122,304	27.5	125,689	12.8
Animal & animal products	2,274	785	219	12	3,290	0.6	1,014	1,983	2,997	0.7	6,287	0.6
Apparel	1,509	239	0	0	1,748	0.3	770	6,617	7,387	1.7	9,135	0.9
Vegetable products	1,397	0	0	41	1,438	0.3	257	371	628	0.1	2,066	0.2
Chemical products	480	134	0	0	614	0.1	10	0	10	0.0	624	0.1
Photographic, precision instruments	567	10	0	0	577	0.1	63	0	63	0.0	640	0.1
Transport equipment	0	385	117	0	502	0.1	0	0	0	0.0	502	0.1
Furniture & Assorted products	260	9	0	1	270	0.1	0	22	22	0.0	292	0.0
Base metals and their products	74	131	0	0	205	0.0	0	111	111	0.0	316	0.1
Animal and vegetable oils	0	35	0	0	35	0.0	0	0	0	0.0	35	0.0
Plastic & rubber products	0	21	0	0	21	0.0	0	7	7	0.0	28	0.0
Objects d'art	10	0	0	0	10	0.0	0	0	0	0.0	10	0.0
Skins & furs and their products	8	0	0	0	8	0.0	0	0	0	0.0	8	0.0
Oil and mineral products	1	0	0	0	1	0.0	0	0	0	0.0	1	0.0
Stone, ceramic & glass products	1	0	0	0	1	0.0	1	42	43	0.0	44	0.0
Shoes, hats, umbrellas, etc.	0	0	0	0	0	0.0	0	12	12	0.0	12	0.0
Total	497,824	23,010	12,612	2,184	535,630	100.0	288,097	157,004	445,101	100.0	980,731	100.0
Share %	20.9	1	0.5	0.1	22.5		12.1	6.6	18.7		41.2	

	Asia non ASEAN					GSP		Rest of the World	World			
	China	Japan	Korea	Hong Kong	Taiwan	Total	% Share		USA	EU15	Total	% Share
Wood products & paper	5	0	8	106	392	511	0.1	1,877	9	4	684,018	28.7
Rubber	4,487	0	608	500	5,313	10,908	3.0	0	0	0	95,012	4
Wood	151,202	14,821	83	84,551	66,481	316,138	85.9	34	25	17,687	390,912	16.4
Electrical and Mechanical machines	27	628	47	100	1,400	2,202	0.6	289	2,616	928	13,714	0.6
Textiles	267	0	584	1,189	1,542	3,582	1.0	1,681	357	10	10,243	0.4
Processed foods, drinks & tobacco	144	24	210	251	488	1,117	0.3	113	662	9,407	136,989	5.8
Animal & animal products	1,437	143	10	10,029	136	11,755	3.2	936	3,158	873	23,009	1
Apparel	620	2,750	13	1,972	123	5,478	1.5	481,748	463,864	11,604	971,831	40.8
Vegetable products	742	0	221	528	1,341	2,832	0.8	0	255	3	5,156	0.2
Chemical products	106	0	0	0	0	106	0.0	36	42	17	826	0
Photographic, precision instruments	0	76	45	51	0	172	0.0	781	355	0	2,038	0.1
Transport equipment	0	58	0	0	0	58	0.0	3,870	330	2,650	7,409	0.3
Furniture & Assorted products	4	204	5	188	19	420	0.1	0	491	16	1,219	0.1
Base metals and their products	0	13	0	333	29	375	0.1	0	113	0	804	0
Animal and vegetable oils	0	0	0	0	0	0	0.0	0	0	0	35	0
Plastic & rubber products	8	0	0	380	68	456	0.1	100	25	0	609	0
Objects d'art	3	0	0	0	0	3	0.0	4	9	39	65	0
Skins & furs and their products	0	0	128	0	0	128	0.0	1	0	0	137	0
Oil and mineral products	0	3	0	0	0	3	0.0	0	1	0	5	0
Stone, ceramic & glass products	0	0	297	0	19	316	0.1	0	192	18	570	0
Shoes, hats, umbrellas, etc.	0	10,972	0	0	498	11,470	3.1	5,213	18,839	706	36,241	1.5
Total	158,051	29,691	2,259	100,179	77,850	368,030	100.0	496,773	491,345	43,963	2,380,843	100
Share %	6.6	1.2	0.1	4.2	3.3	15.4		20.9	20.6	1.8	100	

Source: Free Trade Area Membership as a Stepping Stone to Development – The Case of ASEAN, World Bank Discussion Paper No. 421, based upon 1998 Import-Export Statistic of MOC