

ADB Working Paper Series on Regional Economic Integration



Impediments to Growth of the Garment and Food Industries in Cambodia: Exploring Potential Benefits of the ASEAN-PRC FTA

Vannarith Chheang and Shintaro Hamanaka

No. 86 | September 2011



ADB Working Paper Series on Regional Economic Integration

Impediments to Growth of the Garment and Food Industries in Cambodia: Exploring Potential Benefits of the ASEAN-PRC FTA

Vannarith Chheang⁺ and Shintaro Hamanaka⁺⁺

No. 86 | September 2011

The authors would like to thank Jayant Menon for useful comments and suggestions.

⁺ Executive Director, Cambodian Institute for Cooperation and Peace.

⁺⁺ Economist, Office of Regional Economic Integration, Asian Development Bank, 6 ADB Avenue, Mandaluyong City, 1550 Metro Manila, Philippines. Tel: +63 2 632 5844, Fax: +63 2 636 2342, email: shamanaka@adb.org

The ADB Working Paper Series on Regional Economic Integration focuses on topics relating to regional cooperation and integration in the areas of infrastructure and software, trade and investment, money and finance, and regional public goods. The Series is a quick-disseminating, informal publication that seeks to provide information, generate discussion, and elicit comments. Working papers published under this Series may subsequently be published elsewhere.

Disclaimer:

The views expressed in this paper are those of the authors and do not necessarily reflect the views and policies of the Asian Development Bank (ADB) or its Board of Governors or the governments they represent.

ADB does not guarantee the accuracy of the data included in this publication and accepts no responsibility for any consequence of their use.

By making any designation of or reference to a particular territory or geographic area, or by using the term “country” in this document, ADB does not intend to make any judgments as to the legal or other status of any territory or area.

Unless otherwise noted, \$ refers to US dollars.

Contents

Abstract	iv
1. Introduction	1
2. Garment Industry	3
2.1. Company A (Cotton Producer and Exporter)	4
2.2. Company B (Textile Producer and Exporter)	6
2.3. Company C (Textile Producer)	7
2.4. Summary of Empirical Findings of Garment Industry Case Studies	9
3. Food Industry	10
3.1. Company D (Rice Producer and Exporter)	10
3.2. Company E (Rice Exporter)	12
3.3. Company F (Food Producer)	13
3.4. Company G (Palm-Related Food Producer and Exporter)	14
3.5. Summary of Empirical Findings of Food Industry Case Studies	16
4. Policy Considerations	17
References	20
Annex: Questionnaire for the Project—The Impacts of Regional Trade Arrangements on Cambodian Industries	21
ADB Working Paper Series on Regional Economic Integration	22

Abstract

This paper attempts to identify structural constraints to growth and exports within Cambodia's key industries and to consider the policy actions needed to reduce obstacles to trade. The paper places special emphasis on Cambodia's exports to the People's Republic of China (PRC), given the major export opportunities arising from the free trade agreement (FTA) between the Association of Southeast Asian Nations (ASEAN) and the PRC, known as the ASEAN-[People's Republic of] China FTA (ACFTA). A qualitative case study method was applied at the firm-level by conducting face-to-face interviews to identify the impediments to the growth and exports of key industries in Cambodia, and to examine the opportunities and challenges presented by the ACFTA. This study covers the garment and food industries, which are critical to the economic development of Cambodia in the context of regional and global economic integration. The food industry, with its large number of small and medium-sized enterprises, has great potential for contributing to pro-poor growth in Cambodia, while the textile industry is the largest employer in the Cambodian labor force and is critical for poverty reduction efforts through export-led growth. The study also provides policy recommendations at both the industry and government levels.

Keywords: Cambodian economy, garment industry, food industry, ASEAN-[People's Republic of] China FTA, firm-level analysis, bribery

JEL Classification: F13, F14, F15

1. Introduction

Exports are a driving force for economic development in many emerging economies. This is especially true for transitional economies in Southeast Asia, such as Cambodia, that are in the midst of rapid regional and global economic integration. The recent phenomenon of signing free trade agreements (FTAs) brings both considerable opportunities and challenges to the industries of the contracting parties. In particular, the free trade agreement (FTA) between the Association of Southeast Asian Nations (ASEAN) and the People's Republic of China (PRC), known as the ASEAN–[People's Republic of] China Free Trade Agreement (ACFTA), has attracted considerable attention from policymakers and researchers because of its potential impact on the region's economies.

However, transitional economies in Southeast Asia may not be able to easily exploit the benefits of FTAs such as ACFTA. Given that industries in these countries are vulnerable to external shocks, a close examination of the potential positive and negative impacts of ACFTA is critical in designing relevant trade adjustment policies. In addition to the difficulty of taking advantage of preferential access to partner economies under an FTA, traders in ASEAN's poorer members face more fundamental impediments such as burdensome paper work and under-the-table fees. Thus, it is important to address both the general issues of trade impediments and the obstacles that prevent traders from maximizing the benefits of FTAs, and to consider the necessary policy actions. This paper assesses the impediments to exports in the case of Cambodia, with special reference to the impacts of ACFTA¹ on key industries in the country.

There are various complementary methods that can be used to assess the effects of FTAs. While the gravity model is a popular ex-post method, the results should be carefully read if it will be used to analyze the impact of the ACFTA, particularly on Cambodia.² Any macro-level model exercise should be accompanied with micro-level analysis in order to infer clear policy implications. Meanwhile, the majority of existing firm-level surveys that assess the impact of FTAs in Asia tend to focus mostly on incumbent exporting firms in major Asian countries, usually not including Cambodia. While the conduct of large-scale firm-level surveys in Cambodia should be encouraged, a methodological problem of the firm-level survey is persistent, especially when analyzing less developed countries (LDCs) like Cambodia. Random sampling or even complete enumeration (census) surveys of exporting firms do not produce plausible policy implications for countries' export strategies because potential users of FTAs are non-exporters at this stage. This is especially true in the case of LDCs, including

¹ In addition to the ACFTA, Cambodia, as an ASEAN member, also participates in trade agreements with Japan and the Republic of Korea. However, given the rapid increase in trade with the PRC, this study focuses exclusively on impacts of the ACFTA. According to the United Nations Comtrade Database (UN Comtrade), Cambodia's exports to the PRC increased 154% from \$36.6 million in 2009 to \$93.6 million in 2010, while Cambodia's exports to Japan increased 46% from \$142.6 million in 2009 to \$207.8 million in 2010. Cambodia's trade with the Republic of Korea in 2010 had not been reported by UN Comtrade as of 12 July 2011.

² First, the ACFTA is a fairly recent phenomenon and available data series since its implementation is very limited. Second, the accuracy of macroeconomic data from LDCs, such as Cambodia, is questionable.

Cambodia, as will be discussed later. Furthermore, information on the use or non-use of FTAs is not the only type of information that is valuable—detailed anecdotal information on the impediments to trade in the general sense, as well as on specific obstacles to the use of the ACFTA, should be collected through interviews.

This paper employs a qualitative case study method based on semi-structured interviews with corporate executives in Cambodia. Such a method is particularly useful for examining opportunities and challenges of FTAs in developing countries such as Cambodia, which lacks quality economic data.³ Because it provides the micro-foundation of the overall assessment of FTA impacts, the case study approach complements other methodologies including the gravity model and firm-level survey mentioned above. If used properly, the case study approach is useful for extracting relevant information to draw up the necessary adjustment policies.⁴ An interview-based case study method is helpful in identifying what the real bottlenecks to exports are, what type of assistance should be offered by the government to firms to increase exports, why firms do not export despite FTA preferences, and what kind of policy reforms are necessary to exploit the export opportunities under FTAs. Based on the responses of several interviewees, specific industry problems with regard to trade under FTAs can be identified, thereby avoiding over-simplification. This paper not only analyzes the trade policy of each company surveyed, but also attempts to clarify the difficulties faced by each industry as a whole in the context of the ACFTA.

We conducted semi-structured interviews in the Khmer language with several firms⁵ in Cambodia in May–July 2010. We carefully selected the firms to interview, considering several factors including (i) balance across subsectors, (ii) size of firms, and (iii) firms' trade volume. In most cases, a questionnaire focusing on exports to the PRC was sent to interviewees beforehand in both English and Khmer (see Attachment 1 for the questionnaire in English). Both the questions identifying the general impediments to Cambodia's trade and the questions relating to the use of the ACFTA were included in the questionnaire. Rather than testing a specific hypothesis in a purely social scientific manner, the objective was to gather as much relevant information as possible and to construct anecdotal case studies. Face-to-face interviews were then conducted with additional questions added based on the responses to the questionnaire. These were followed up by telephone-based interviews when necessary.

This paper analyzes two major industries in Cambodia: the garment industry and the food industry. Those two were selected because both are vital industries in Cambodia in terms of production, employment, and exports, and because the two have several contrasting features. The garment industry is the largest industry in terms of output and exports. The majority of firms in this industry are relatively large and have strong export orientation, and most of them have foreign equity participation. In contrast, the food industry is a typical example of a domestic industry in Cambodia with significant economic potential. The majority of firms in the food industry are small and medium-

³ On the quality of trade statistics of Cambodia, see Hamanaka (2011).

⁴ For example, there is an incentive to exaggerate the negative side of FTAs in the expectation of government assistance. This problem can be minimized if an interviewer poses relevant follow-up questions.

⁵ However, not all of the interview summaries of the selected firms are included in this paper.

sized enterprises (SMEs), and further development of the industry is crucial for poverty reduction.

The next section covers the garment industry and the subsequent section focuses on the food industry. Each section starts with a brief introduction of the industry and moves on to individual companies' export policies in the context of the ACFTA. Each section concludes with a summary of empirical findings on the respective industries' problems in terms of trade. After the examination of the two industries, the final section of the paper considers policy recommendations that aim to maximize the benefits and minimize the costs of the ACFTA.

2. Garment Industry

The garment industry is the largest industry in Cambodia, accounting for approximately 20% of all Cambodian production, 14% of gross domestic product (GDP), and 72% of total merchandise exports. It employs 320,734 workers, among which 293,664 are women, working in 269 factories across the country.⁶ The garment industry is the main income generator within the Cambodian labor force. It is also the country's largest foreign currency earner and contributes about 80% of Cambodia's foreign exchange earnings every year.⁷

The Cambodian garment industry began to develop in earnest in the 1990s, with a strong orientation toward exports. The industry's production has since reached a level equivalent to 500% of what is required for self-sufficiency. The main markets for Cambodian textiles are the United States (US), European Union (EU), Canada, and Japan.⁸ This industry is dominated by large-sized, foreign-owned firms. In 2009, the total number of large factories in Cambodia registered with the Ministry of Industry, Mines, and Energy reached 556, of which 422 were garment-related.⁹ According to the Garment Manufacturers Association in Cambodia, there are currently 136 export-oriented garment factories in Cambodia, of which 93% are foreign-owned. Most foreign direct investment in Cambodia—mainly from the PRC and Taipei, China—goes to this industry.

The garment industry emerged in response to the trade privileges established under the Generalized System of Preferences (GSP) in 1996 by the US and EU. In 1998, the Clinton administration initiated the US–Cambodian Trade Agreement on Textiles and Apparel (1999–2004), which linked market access (with an increasing quota) for Cambodian textiles products to labor standards. Cambodia is the only country where a

⁶ According to People's Daily Online, Cambodia employs 320,734 workers in 269 garment factories. Available at <http://english.people.com.cn/90001/90777/90851/6990883.html> (accessed 20 May 2010).

⁷ Business in Asia. Update on Cambodian Garment and Textile Industry. Available at http://www.business-in-asia.com/industries/cambodia_garment.html (accessed on 20 May 2010).

⁸ In 2009, total garment exports to foreign countries amounted to \$2,385 million, of which \$1,486 million was exported to the US, \$577 million went to European markets, \$184 million went to Canada, and \$136 million went to other countries.

⁹ A factory or business establishment with more than 100 employees and assets over \$500,000 (excluding land) is considered a large business by the Cambodian government (Government of Cambodia 2005).

trade–labor arrangement was agreed to and implemented in order to secure a quota for exports to the US.¹⁰ In 1999, the US imposed new quotas on all textile exporting countries except Cambodia. Meanwhile, the textile agreement between Cambodia and the EU entered into force on 1 July 1999. This agreement formalized the principle of unlimited access of Cambodian textile products to the EU market. The privilege of unlimited access was supplemented by a liberalization of the conditions of access to the EU's GSP scheme, which grants an exemption from customs duties to Cambodian exports entering the EU market. The first measure of liberalization under the agreement included the indefinite granting to Cambodia in September 1999 of the benefit of "regional accumulation." With this privilege, unfinished textile products imported by Cambodia from another member of the Association of Southeast Asian Nations (ASEAN) and then exported to the EU are considered to be of Cambodian origin, allowing Cambodia to more easily satisfy the GSP rules of origin.

In the middle of the 1990s, many firms began moving to Cambodia from the PRC; Indonesia; Republic of Korea; Taipei, China; and Thailand for three primary reasons. First, wage rates in Cambodia were relatively low compared with its competitors. Second, Chinese companies in particular moved their factories to Cambodia in order to have preferential access to US and European markets since the Multi Fiber Agreement (MFA), which imposed quota restrictions on textile products and especially textile products from the PRC, was in effect until 2004.¹¹ Finally, the 1997/98 Asian financial crisis served as an impetus for the rapid development of the textile industry in Cambodia, which had been less affected by the crisis.

Cambodia captures a relatively limited share of the value chain in the global garment industry. Cambodia is involved in the "cut, make, and trim" phase of the value chain. The Cambodian industry produces only garments, while most of the raw materials, fabrics, and machines are imported from the PRC and other countries in the region. According to the Garment Manufacturers Association of Cambodia, the country's garment industry imported \$1 billion in raw materials in 2009, with 66% imported from the PRC and the rest from Taipei, China and the Republic of Korea. According to Cambodian taxation law, the import taxes on raw materials serving industries in the country are very low if the final outputs are exported. Because the industry enjoys import tax exemptions as well as tax holidays,¹² the industry's direct contributions to government revenue have been limited. More than 95% of garment factories are foreign-owned, and a significant part of the profits are repatriated. Nevertheless, this industry is critical for poverty reduction in Cambodia due to its contribution to export-led growth.¹³

2.1. Company A (Cotton Producer and Exporter)

Company A is a major cotton exporter. The company was founded in 2006 by a Cambodian businessman with the primary goal of exporting cotton to the PRC. A

¹⁰ Ear (2009, p. 7).

¹¹ Even after the end of the MFA in 2004, the garment industry in Cambodia was still able to compete in international markets and maintain its dynamism in exporting to US, European, Canadian, and Japanese markets.

¹² Ear (2009, p. 8).

¹³ Yamagata (2006).

Chinese businesswoman visited Battambang province in Cambodia and suggested to the eventual founders of Company A that they grow cotton for export to the PRC. She offered assurances that she would buy all of the cotton produced by the company. The founders of Company A visited the PRC several times to study its local markets and decided to start their business upon returning to Cambodia.

Today, Company A has a total of 80 employees, of whom 40 are regular staff, and investment capital worth over \$2 million. It has a cultivated land area of over 1,500 hectares, up from 100 hectares at its inception, in the Rottanak Mondul district of Battambang province. The total export volume of Company A reached 150 tons per year in 2009 and the company is one of Cambodia's top cotton exporters. The main export markets include Viet Nam, the PRC, Japan, and the Republic of Korea. Even though the PRC only began importing cotton from this company in February 2010, it has already become the firm's second largest market at 50 tons per year, trailing only Viet Nam. When asked why the firm only started to export cotton to the PRC in February 2010, the company's management confessed that it tried to avoid relying too much on exporting to the PRC to prevent having low prices dictated to it by its Chinese partner. But at the same time, the company's management admitted that they rely heavily on their Chinese business partner in order to export to the Chinese market. Company A does not have information about the end-users of their products, which are factories in the PRC. Instead, the company relies heavily on middlemen to market its products in the PRC.

Recently, Company A decided to import several modern cotton processing machines from the PRC at the price of \$600,000 per unit. In spite of the high cost, the company decided to purchase the machines because the import process was straightforward and free from overly bureaucratic procedures. In addition, the Cambodian government reduced the importing tariff (custom duty) imposed on these machineries to zero.¹⁴ In this example, Company A has clearly benefited from the ACFTA in terms of reduced input expenses.

When asked whether the firm could compete with products imported from the PRC, Company A's project manager was confident about the quality of his products. The quality of the firm's cotton has been tested in a laboratory in the PRC and the results showed that his products were superior to similar items from other countries, including the PRC, with respect to the cotton's endurance and whiteness. In fact, business partners, not only in the PRC, but also in Japan and the Republic of Korea, have praised the quality of Company A's products. Companies in the PRC, Japan, the Republic of Korea, and Viet Nam have promised to purchase all of the cotton that Company A can produce. However, the company's management worries that they may not be able to supply all of these markets in a timely fashion since cotton requires a much longer period and more land under cultivation to grow than other plants and crops.¹⁵

In spite of positive developments with regard to exporting, the Company A project manager admitted that there are some problems regarding export procedures. Without

¹⁴ In addition, other taxes on raw materials imported from the PRC to Cambodia, such as cotton seeds and the accompanying packing materials, were also abolished under the ACFTA scheme.

¹⁵ For instance, at least 260 cotton fruits are used to make 1 kilogram of cotton.

disclosing how much he has to pay for getting an export permit, he admitted that the permit process requires that unofficial fees be paid to avoid delays.

In addition to this problem faced by Company A on the Cambodian side of the border, the project manager identified another major problem on the PRC side. When the products arrive in the PRC, Chinese customs officers require his business partner, who is in charge of conducting import procedures, to fill in a number of papers in addition to the certificate of origin, a process which usually takes about 1 month. Only after all paper work has been finished can the products be imported. On the other hand, customs officers in Viet Nam do not require many papers (except the certificate of origin), according to the project manager. This is one of the reasons why Company A chooses to export more to Viet Nam than to the PRC.

To cope with these challenges, Company A suggested that the government help the company by easing its export procedures and custom clearance processes. For instance, the government could charge a fee for phytosanitary inspection only, with the rest of the procedures eliminated. In addition, the company's management also requested that the Cambodian government grant multiple export permits with a certain validity period (e.g., 1 year) so that the firm need not waste resources completing paperwork for each export transaction.

2.2. Company B (Textile Producer and Exporter)

Company B is a supplier of apparel products. The company produces its products in accordance with the design, quality, and quantity requested by buyers from other countries, particularly in Europe and Canada. The trademark and brand names of the products are designed by either the buyers or partner companies. Company B was established in 2000 by an entrepreneur from Hong Kong, China. The parent company, which is in charge of finding buyers and partners, was established in Hong Kong, China and its factories are located in the PRC and Cambodia. Company B has established strong business connections with buyers in Europe. The factory in Cambodia employs 400 staff, 90% of which are female. The company produces jackets and sweaters, all of which are exported to Europe.¹⁶ The production inputs of the company are raw materials imported from the PRC and the labor inputs are sourced from the local Cambodian people. Given that almost all textile producers in Cambodia are just suppliers and they are not involved in the process of selling in the market, Company B is a typical example of an export-oriented firm in the garment industry in Cambodia.

The company tracks preferential trade arrangements provided by other countries and regions to Cambodia, though the company has never been involved in trade negotiations. Europe has been beneficial for Cambodia's textile exporters ever since the former provided special trade treatment for Cambodian products under the Everything-But-Arms Agreement. As a result of this preferential trade treatment, Company B started operating in Cambodia with the intention of exporting to Europe.

¹⁶ The company does not have any plans to expand its sales in ASEAN markets because the company's products, jackets and sweaters, are not suitable for tropical ASEAN countries.

When asked about the ACFTA, the company representative said that she was not aware of the agreement and it did not affect Company B's operations since it was already importing raw materials from the PRC based on a freight-on-board (FOB) basis, thereby avoiding import tariffs in accordance with Cambodian investment law and the investment facilitation policy of the Cambodian Council of Development.¹⁷ While the company is interested in learning whether there are any enhanced export opportunities with the PRC under the ACFTA, there seems to be a very little opportunity for now, due to the fact that products from the PRC are very competitive. The Company B case study suggests that the ACFTA may have little impact on Cambodian garment producers, especially those that are export-oriented since their market is primarily Europe and not the PRC, and those that import raw materials from the PRC already enjoy import tariff exemption under the existing trade regime.

Regarding competition in other markets (especially Europe), there is some competition between Cambodian products and those from other countries, including the PRC. However, it is the buyers that draw up the marketing strategies, and Company B itself is not directly involved in such competitive processes. The administrative and shipping officers of Company B are wary that if the special treatment under the Everything-But-Arms Agreement were ended, there would be an increase in competition with Chinese products in European markets. However, Company B still believes that Cambodian labor, which is much cheaper than labor in the PRC, will continue to make Cambodian garment products competitive.

2.3. Company C (Textile Producer)

Company C is a textile manufacturer that is owned by a Cambodian businesswoman and has current investment capital of more than \$140,000. The company began its operations in 1995. Prior to starting Company C, the owner opened a business in 1990 as a clothes vendor at the Olympic Market,¹⁸ which is the largest clothes wholesaler in the capital Phnom Penh. Realizing that Cambodia did not produce cotton fabrics, she came up with a plan to import raw materials, particularly cotton fabrics from foreign countries, and assemble them in Cambodia to produce clothes. Based on cost calculations, she realized that her products would be highly competitive, given relatively cheap labor in Cambodia and her company's product design, which is suitable for Cambodian preferences. Fortunately, her relatives helped her by suggesting where and how to purchase cotton fabrics from Thailand for use in making her own clothes. Her business has grown since 1995. At its peak, between 40 and 50 packages of ready-made clothes were sold daily with a total value of \$4,000–\$5,000.¹⁹ The number of employees reached 30 in 2006.

However, sales in recent years have dropped drastically, with only a few packages of ready-made clothes sold daily. Sales now average as low as \$200–\$300 per day. In response, Company C's owner decided to reduce the number of employees to about 10.

¹⁷ Company B enjoys other tax incentives, including tax holidays, because the company is 100% export-oriented.

¹⁸ She later began selling her products at other markets in Phnom Penh including Oruessei Market, Central Market, Deum Kor Market, and Chbar Ampaov Market.

¹⁹ One package contains 12 pieces of ready-made clothes.

When asked to give the reason for sharply decreasing sales in recent years, she pointed to the massive inflow of ready-made clothes imported from the PRC. Huge numbers of Chinese products are now sold at Olympic Market and other markets. The Chinese ready-made clothes are cheaper than her products by \$1.00–\$2.50 per item, while the quality of the products is about the same.

When asked to give reasons why she could not reduce the price of her clothes to compete with imports from the PRC, the owner identified high input costs resulting from transport fees, the tariff imposed on imported cotton fabrics, and high electricity costs in Phnom Penh. For example, the tariff imposed on cotton fabrics imported from Thailand and the PRC are both 7% of the total price of the materials. The government provides special tax treatment to export-oriented producers, but not to local market-oriented small companies like Company C. Domestic-oriented SMEs are required to pay import taxes for the cotton fabrics. In addition, the fabrics imported from the two countries are subject to a 10% value added tax (VAT).

The loss of competitiveness vis-à-vis ready-made clothes from the PRC has led the owner of Company C to seek cheaper inputs by importing cotton fabrics from Indonesia. The owner revealed that the cost of Indonesian fabrics is about \$1.00 per yard (including the import tariff), while the cost of Thai fabrics is about \$1.50 per yard. However, the company's owner was still uncertain whether her final products would be able to compete with Chinese ones even if Indonesian inputs were used. The owner of Company C suggested that the Cambodian government should assist garment-producing SMEs by eliminating tariffs imposed on cotton fabrics imported from ASEAN member countries.

When asked why she did not import cheap Chinese raw materials, especially cotton fabrics, Company C's owner confessed that she did not know anyone who could advise her on the PRC's fabric market and export procedures. She has instead decided to import fabrics from Indonesia and Thailand since she has a relative, who used to trade with Indonesian and Thai cotton fabric suppliers in the past, help her make arrangements with the suppliers and facilitate the importing process.

There are several reasons why Company C does not use home-made cotton (from the Company A plant, for example) in order to minimize input costs. First, Cambodian cotton plants do not yet have the capacity to produce the end product: cotton fabrics. They focus more on producing semi-processed cotton for export to other countries that are then used to produce cotton fabrics. A second and related reason is that most cotton plants in Cambodia are export-oriented and are inclined to sell their products to international rather than local markets since they want higher prices.

High electricity costs in Cambodia are another driver of high production costs for Company C. For instance, electricity costs in Phnom Penh range from Riel 610 (\$0.14) to Riel 720 (\$0.17) per kilowatt, depending upon the consumption level. The more electricity consumed, the higher the price per kilowatt that users have to pay. While this policy is designed to help minimize electricity consumption, such a pricing mechanism makes the realization of economies of scale difficult.

In conclusion, the case of Company C shows that the ACFTA may have a serious adverse impact on small Cambodian garment producers whose production is mostly based on raw materials imported from ASEAN countries rather than the PRC. With the same treatment for imported ASEAN and Chinese products (tariff and VAT), ASEAN textile producers that import raw materials from ASEAN countries to produce end products such as clothes may not be able to compete with ready-made clothes from the PRC because of their extremely low prices. This suggests that ASEAN should abolish the tariff imposed on raw materials imported from other members as soon as possible so that the products of small ASEAN textile manufacturers can become more competitive with PRC textile imports.

2.4. Summary of Empirical Findings of Garment Industry Case Studies

First, the bottleneck of Cambodia's garment industry is due to the fact that there are no mid-stream sectors in the whole value chain, while its upstream and downstream sectors are strong. The upstream sector—cotton production—is very competitive even when compared with the PRC, and the majority of production is exported to other countries, mainly European markets. Most of the downstream sectors are also notably export-oriented. The majority of them simply produce final products, using imported materials, based on the design and orders from companies and buyers in other countries, particularly in Europe. While the upstream and downstream sectors in Cambodia's garment industry are competitive, the industry as a whole has not exploited business opportunities due to the lack of midstream sectors. In fact, the production of fabrics and textiles in Cambodia is very limited. Naturally, companies in upstream and downstream sectors concentrate on exporting their products, rather than establishing a complete value chain in the country. If efficient midstream sectors existed in Cambodia, then domestic companies would be able to produce clothing and apparel final outputs using fabric and textiles made in country with Cambodian cotton.

Second, export procedures in Cambodia sometimes constrain the domestic garment industry, although the frequency of this happening seems to be low compared with other industries. For example, export procedures are a more urgent problem for the Cambodian food industry, which will be discussed in the next section. If the government were to grant a multiple export permit with a certain validity period, instead of a series of single permits, firms could save time by avoiding tedious paperwork. The PRC's cumbersome import procedures also affect Cambodia's exports to the PRC. Several companies point out that customs in the PRC require several certificates in addition to certificates of origin, which is not the case with Cambodian exports to other neighboring countries, including Viet Nam. Thus, Cambodian companies tend to export to Viet Nam than the PRC.

Finally, the impacts of the ACFTA on Cambodia's garment industry, which is generally an export-oriented industry led by a small number of large-scale, foreign-owned companies, are limited. However, the ACFTA has had some adverse effects on domestically-oriented SMEs. Large-scale companies, whose products are typically exported, are already enjoying the tariff-free import of their materials under Cambodian investment law. Thus, there is no impact of the ACFTA on their imports from the PRC. Because large-scale companies' main export markets are in Europe, the ACFTA does

not have a substantial impact on their exports either. In contrast, domestically oriented SMEs, whose sales principally target domestic markets, face substantial negative effects from the ACFTA, usually without enjoying any benefits. Under the ACFTA, final apparel products made in the PRC enter the Cambodian market without tariffs, where there is already fierce competition. Moreover, because their products are sold domestically, SMEs are unable to import raw materials tax free, unlike large foreign firms. A lack of business partners in the PRC is another reason why some firms import materials from other ASEAN countries instead of the PRC.

3. Food Industry

The manufacturing industry in Cambodia is still in its infancy, predominated by light industries that employ low technology. However, Cambodia is now pursuing a more export-oriented, rather than an import-substitution, development policy. The garment industry is the top export-oriented manufacturing sector in Cambodia. Other light industries, especially the food industry, are focused on local rather than foreign markets. The food industry in Cambodia has the potential to expand its international sales by utilizing mass production with low input costs and high quality output.

SMEs, which make up approximately 95% of all enterprises and account for almost half of all employment, are the backbone of the Cambodian economy. The government of Cambodia has emphasized the important role of SMEs in economic growth and poverty reduction in its Second Socio-Economic Development Plan and National Poverty Reduction Strategy. According to the Cambodian Ministry of Industry, Mines, and Energy, in 2006, 82% of SMEs were in the beverage, food, and tobacco sector (USAID 2006). Given that such a major portion of the workforce is employed in this industry, its development is critical for pro-poor growth in Cambodia.²⁰

The food processing industry in Cambodia is still in a developing stage. It is facing several constraints and weaknesses including the lack of processing facilities, food processing technology and skills, market analysis and marketing information, and sanitation and hygiene knowledge; as well as poor infrastructures, an unreliable supply of raw materials, and the low levels of competitiveness among its products due to high operating costs.²¹

3.1. Company D (Rice Producer and Exporter)

Company D is a company that operates various businesses within the rice industry, including milling, purchasing, and exporting. Company D was founded by a Cambodian businessman in 1993 with an initial investment of slightly more than \$10,000. Today, it has become one of the country's main rice producers and exporters, employing 80 people and with investment capital of approximately \$2 million. Only six staff members earn a regular annual salary, while the rest are paid a daily allowance of about \$3 per day. The firm has the capacity to produce 110 tons of rice per day to meet local and

²⁰ Kobayashi et al. (2009).

²¹ COSECAM and Plan Cambodia (2009, p. 23)

overseas demand, which is a significant increase from only 8 tons per day during its initial years. Company D exports about 3,000 tons of rice each year, accounting for 0.6% of total Cambodian rice exports.

The company exports rice to foreign countries such as Switzerland; Italy; France; Portugal; Hong Kong, China; and the US. The company's founder is not worried about competing with products from the PRC in international markets, as he strongly believes in the quality and relatively low price of his rice. When asked why the company has not exported to the PRC (or Hong Kong, China), the respondent confessed that he had always wanted to do so, but he has yet to establish a connection with any middleman who could introduce his company to clients in the PRC. For this reason, Company D plans to dispatch a market study team to the PRC in the near future to conduct a feasibility study and, if possible, establish trade ties with a rice-importing firm.

Even though Company D had little knowledge about specific opportunities available through the ACFTA, the firm has already benefited from the ACFTA to a certain extent. The respondent said that the company's rice productivity has dramatically increased in recent years due to the application of more advanced technologies in the production process. These technologies, particularly rice-colored selection machines, are imported from the PRC. The general director of Company D decided to purchase these machines from a local supplier because their quality is similar to those of machines imported from Japan and Thailand, while the cost is much less. Rice-colored selection machines made in the PRC cost about \$30,000 per unit in Phnom Penh compared with similar machines imported from Japan and Thailand that cost approximately \$60,000 per unit. Import tariffs on agricultural machines from the PRC were reduced to zero in May 2008, creating favorable conditions for the rice milling industry to raise its competitiveness in both local and international markets.

The firm still faces complicated exporting procedures, which cause delays in delivering products to its foreign clients. In order to encourage exports to foreign countries such as the PRC, the company strongly seeks the easing of the Cambodian government's export procedures, which are the source of two main problems. First, the delivery process of products is regularly delayed as companies spend too much time clearing export applications through the two main government ministries: the Ministry of Commerce and the Ministry of Agriculture, Forestry, and Fisheries. It takes at least 5–7 days to finish the paperwork before a firm can proceed with actual exporting. Second, the time and costs of export logistics lead to increases in the total costs of products, and this leads to significant increases in prices that lower the amount of revenue generated from exports. For example, Company D has to go through at least 15 checking processes and is required to pay for each process, including unofficial solicitation fees, before being able to export its products, resulting in higher expenses. The company has to spend more than \$1,000 for each container filled with 20 tons of rice (around \$55 per ton) for transport and delivery from Phnom Penh to Sihanoukville, including the export paperwork. Rice exporters from Viet Nam spend approximately \$500 for the same size container for intra-Viet Nam transport costs, according to Company D's general director.

While Company D still uses the Cambodian port of Sihanoukville because it generates revenue for the Cambodian government, some exporting firms have decided to export

products through Viet Nam's international sea port rather than Cambodia's, because of costly and time-consuming export procedures associated with the former. Truck loading containers are used to transport products from Cambodia, specifically Phnom Penh, across the Cambodia–Viet Nam Border (Bavet) to Saigon Port in Ho Chi Minh City. This transport route is considered by some firms to be faster and less costly than the route from Phnom Penh to Sihanoukville. The documents required for products to be exported or transited to Viet Nam are bills of product and packaging invoices, and in some cases, certificates of rules of origin and phytosanitary documents. While the required documents are almost the same in both countries, transiting through Viet Nam may be less time-consuming and less costly because of its geographical proximity, better infrastructure connectivity, and faster customs procedures. Company D's general director anticipates that more Cambodian exporting firms will begin using Vietnamese ports as their transit point rather than Sihanoukville unless the Cambodian government pursues reform.

On the policy side, Company D's general director suggested that the government help Cambodian rice-exporting firms that are able to compete with the foreign firms, especially PRC firms, in four ways. First, the government can help ease export procedures by following the suggestions offered above. Second, the government should provide loans to exporters to help them expand their business. (In order for Company D to expand business recently it had to borrow money from a private bank at a 10% rate of interest per year.) Third, the Cambodian government should provide more training on new scientific agricultural production methods to Cambodian rice producers to enable them to raise their productivity. Finally, the government should grant exporters a multiple export permit so that they can deliver their products to foreign countries faster and reduce expenses.²²

3.2. Company E (Rice Exporter)

Company E is a rice trading firm. The company was established in 2008 to promote Cambodian rice exports to the region and the world. There are four managing staff members in the company, which has very limited investment capital.²³ Although it is a new trading company, it already has established networks with domestic suppliers as well as overseas clients. Company E conducts transactions with more than 15 milling factories in several provinces in the country. These millers supply high quality rice to the company based on the standards set by overseas clients.

The company has its own in-house export facilitation services and notes that the export process is time consuming and costly. According to the secretary general of the company, complicated bureaucracy and under-the-table exchanges are the main obstacles to efficient exporting. Another issue is the lack of logistics services and the inefficient transportation infrastructure. For instance, the 20-foot containers used in transporting rice can be loaded with only 24 tons of rice, compared with those from Viet

²² Export firms receive a single permit each time they export. If they want to export again, they have to apply for another permit.

²³ The company avails of loans from the bank based on actual orders from foreign clients. As such, the company needs little working capital to invest in this trade.

Nam, which can be loaded with 25 tons of rice. In addition, the road from Phnom Penh to Sihanoukville is very narrow and in poor condition.

The principal export market of Company E is Europe. The quantity of rice exported to Europe has been increasing over the last few years. While the company exported around 70 tons per order in the past, it now exports up to 1,500 tons per order. Such a positive upward trend explains the attractiveness of European markets for Cambodian rice exporters. According to the company, under the Everything-But-Arms Agreement between Cambodia and the EU, Cambodia is now able to export rice products to Europe tariff free. The absence of tariffs increases the competitiveness of Cambodian rice in the European market. The company so far has not had any problem regarding the standard of quality demanded by buyers from Europe.²⁴ With regard to why the company does not export rice to the US or Japan, the secretary general explained that the US and Japan are potentially attractive markets but the company does not have business connections nor has it identified demand in either of these two countries.

According to the secretary general, the PRC's import procedures are complicated since it sometimes does not recognize certificates of origin from Cambodia. Asked why the PRC does not accept certain certificates of origin from Cambodia, the secretary general shared his personal view that PRC authorities probably did not fully trust the documents issued by the Cambodian authorities, despite their obligation to recognize them under both the World Trade Organization (WTO) and ACFTA frameworks.²⁵ Based on its business experiences in the PRC, the company also notes that when rice arrives at ports in the PRC, normally the process of unloading takes up to 7 days. Asked further about their knowledge of the PRC market and ACFTA, the secretary general replied that there was little knowledge about the agreement and he was not aware of the tariff benefits that apply to rice products under the ACFTA. At this stage, complicated trade procedures and a lack of market information on the PRC make Company E more dependent on traditional markets such as the EU for export. In fact, the company exported to the PRC only once in 2009 and found it difficult due to complicated import procedures.

3.3. Company F (Food Producer)

Company F was established in 2002 by a young Cambodian female entrepreneur with the goal of providing jobs to Cambodians, creating a market for local products such as corn and rice, and substituting domestic food products for imported foreign products. Company F has grown quite remarkably since its inception. In 2002, it had only 25 workers and investment capital of about \$100,000. In 2010, the company employed more than 100 regular staff and had working capital of about \$1 million. The company focuses exclusively on the domestic market, with children as its primary market. Since the company's domestic market share is still small, it is looking for international partners to introduce new technology that will lead to a mass scale production system. The

²⁴ The company refused to buy rice that was produced with genetically modified organisms. This is due to restrictions set forth by the EU, which does not accept this type of rice.

²⁵ According to Article 5 of the agreement on trade in goods between ASEAN and the PRC, "the rules of origin and the operational certification procedures applicable to the products covered under this agreement and the early harvest program of the Framework Agreement are set out in Annex 3 of this agreement."

company's net profits are around 10% of total sales and the profit is used mainly for reinvestment and business expansion. The company's vision is to help Cambodian farmers gain market access and to provide employment opportunities to the Cambodian people.

The production cost structure of the company is 40% for packaging, 30% for labor (domestic labor force only), and 30% for other costs (e.g., electricity, water). The reason that packaging is the most costly component among the three is because the company needs to import plastic bags from neighboring countries, mainly Viet Nam, because the packaging industry in Cambodia is not competitive due to high costs and the low quality of its products. (High electricity costs also reduce the competitiveness of Cambodian products.) As a result, overall production costs for Company F in Cambodia are higher than they are for firms in Viet Nam or Thailand.

The lack of sophisticated production technology limits the production capacity of the company. The machinery used for production is second-hand and it is not very efficient. The company spends a lot of money maintaining and repairing its machines. The owner and manager are looking for partnerships or joint ventures with foreign investors to introduce a mass production system and lower the unit cost of production. Without such a technological upgrade, the company is at risk of losing its competitiveness vis-à-vis imported food products from Thailand, Viet Nam, and the PRC.

The company has not yet exported any of its products, but management has a desire to begin exporting products to neighboring countries. However, the complicated export process and lack of capacity (especially in terms of capital and production technology) constrain the company from doing so. Asked about her awareness of the ACFTA, the owner expressed her lack of knowledge on regional trade arrangements. Although the government regularly invites her to attend various workshops and meetings, most of these focus on the development of SMEs producing for domestic markets, not SMEs that export to foreign markets. She urged the Cambodian government and international institutions to further assist the private sector, especially SMEs, in exporting to regional markets and joining regional production networks. In addition, the company expressed the view that the government can assist SME brand promotion in foreign markets, given that it is nearly impossible for SMEs to promote their brands in export markets on their own due to financial constraints.

On the question of whether the company is facing competition with similar products imported from the PRC, the company's owner and manager mentioned that they did have competition in imported food products—especially from Thailand, Viet Nam, and the PRC—but the company is able to compete with imported products through quality, cost, and marketing strategies. The manager is confident that Company F can expand its market share in Cambodia.

3.4. Company G (Palm-Related Food Producer and Exporter)

Company G was registered in 2001. Before the establishment of the company, the owner, a Cambodian–French national, studied products that can be produced from palm juice with the aim of assisting Cambodian farmers. The owner brought palm juice from

Cambodia to France for laboratory research. He learned that wine, organic sugar, and vinegar can be made from palm juice. The owner then decided to invest in building a small factory outside of Phnom Penh to produce products related to palm juice. The products of the company include organic palm sugar, organic vinegar, palm drink, and different types of wine and whisky. With regard to production capacity, the factory can produce 60,000 bottles of wine and whiskey per year, 12 tons of organic palm sugar per year, and 100,000 liters of vinegar per year.

For palm wine and whiskey, the company's main focus is domestic markets, with only around 1% of its total products exported to France. Export to France is usually through unofficial channels such as tourists, friends, and acquaintances. Wine and whiskey bottles are imported from France, which cost about \$1 per bottle. The cost of bottles is high partly due to the fact that the company orders only a small amount of bottles each time. Some type of palm wine costs only \$2, which means that the bottle's cost is already half of the total price. However, the company prefers to import wine and whiskey bottles from France because of their design and quality. Such high costs make the company less competitive in international markets, and moreover, less competitive against imported products in the domestic market.

For organic palm sugar, the main target is international markets. The company now exports organic palm sugar to France; Taipei, China; Japan; Singapore; and the US. The French market is the company's largest. Exports overseas are usually managed through business partnerships with buyers and middlemen from the destination countries. The critical bottleneck to sugar exports are transport costs and customs procedures. The company pointed out the high transport and custom clearance costs in Cambodia. Company G uses transport services from its factory near Phnom Penh to the port in Sihanoukville, supplied by outside service providers, at a cost of \$1,700–\$2,000 per container of organic palm sugar. Packaging costs are also high. About 50% of the total cost of each unit produced is spent for packaging. The company orders plastic boxes from Viet Nam and packs its products in Cambodia. The company finds it difficult to export because of high transport fees and customs clearance costs in Cambodia.

For vinegar, the main market is domestic. The company cannot export vinegar products due to the lack of certificates of standard—such as the Good Manufacturing Practice (GMP), International Standard Organization (ISO), and Applied Science Accreditation Commission (ASAC)—that buyers demand. These standard quality certificates are technical standards that are necessary for the company to export their beverage products to international markets. In order to certify the quality of its products, Company G started to conduct several checks—a visual and tactile check (shape, taste, and texture)—at every stage of the production process, using the latest technology. Through a partnership agreement with Center for International Cooperation in Agronomic Research and Development (CIRAD), training and technical support are being provided to the manufacturing engineers of the company. To get the accreditation certificates listed above is very costly for a small local producer such as Company G. It may take time for the company to expand its production capacity and enlarge its operations, and only then can the company consider applying for these certificates to export.

Company G is interested in expanding its international sales, especially in the PRC. But at the moment, the company finds it difficult to enter the Chinese market due to a lack of price competitiveness vis-à-vis Chinese products. The manager was not aware of the involvement of the private sector in regional trade negotiations and information on regional trade agreements, particularly the ACFTA. The company conducts trade based on business-to-business relationships, with little consultation with (and even less support from) the government. The manager showed interest in exporting the company's products to the PRC under the ACFTA if it could be demonstrated to easily bring preferential market access. The company is also interested in the ASEAN market. The company will seek to expand its market access to the PRC and ASEAN through improved quality and production capacity.

3.5. Summary of Empirical Findings of Food Industry Case Studies

First, the largest bottleneck in Cambodia's food industry, in terms of reducing competitiveness in international markets, is the lack of supporting industries. Food, particularly low value-added food, is generally competitive internationally (e.g., Cambodian rice), but the productivity of Cambodia's processed or value-added food is low because of high costs associated with the packaging process. Because Cambodia does not produce high quality packages, the Cambodian food industry needs to import packaging materials from neighboring countries such as Viet Nam. In the case of palm wine, which is popular in the European market, half of the total production cost is spent on bottles imported from France, since without well-designed bottles it is difficult to sell internationally. Thus, in order for Cambodia's food industry to become profitable enough to successfully export, the establishment of supporting industries is urgently needed.

Second, given the nature of food products, export and import procedures are a more sensitive concern than they are for garment-related products. Sanitary issues are critical for food products and lengthy customs and other procedures significantly affect the quality of some food products. Under-the-table fees are also a major deterrent because they not only increase costs, but also delay the export process. Many firms pointed out that a multiple export permit is necessary to reduce the time and financial costs of trade, and more importantly, to possibly contribute to a reduction in unofficial fees. A lack of high quality transport infrastructure is another issue. Because of these problems, some Cambodian firms export products through Viet Nam to final destinations rather than directly exporting from Sihanoukville.

Third, the impact of the ACFTA on Cambodia's food industry seems to be limited. Above all, Cambodian food producers and traders realize that PRC products are competitive within Cambodian markets, yet it is not easy for Cambodian exporters to penetrate the PRC's markets, with the notable exception of rice. While some firms are interested in exporting to the PRC in the future, limited knowledge of the PRC's markets and the ACFTA, and a lack of business partners and marketing strategies are the main challenges. As a result, the major export market for Cambodian food products has been the EU and this situation seems likely to continue. Meanwhile, tariff-free imports of high quality but inexpensive machines under the ACFTA, such as rice millers from the PRC, contribute to higher levels of productivity throughout the Cambodian food industry.

Fourth, although it is true that the PRC cuts tariffs on food imports from Cambodia under the ACFTA, the PRC's import procedures are sometimes a major obstacle for Cambodian exporters to overcome, especially with respect to food products. The certificates of origin issued by Cambodian authorities are sometimes not fully recognized by PRC authorities and products from Cambodia therefore do not always enjoy preferential status in the PRC's markets. Partly due to complicated procedures required by the PRC authorities, some Cambodian firms either avoid or have given up exporting to the PRC.

4. Policy Considerations

It is true that the ACFTA has created major business opportunities for Cambodian industries. At the macro level, Cambodia's trade with the PRC has been increasing very rapidly in recent years. In 2010, Cambodia's exports to the PRC more than doubled from the previous year.²⁶ Such a macro view is consistent with the export policies of companies analyzed in this paper, some of which have already exported to the PRC or at least have a plan to export their products to the PRC's markets.

At the same time, the ACFTA also presents challenges for key Cambodian industries, including the garment and food industries. The benefits gained are limited to increased market access opportunities for some Cambodian products and to producers who import raw materials and production machines from the PRC. Moreover, the impact of the ACFTA varies across industries in terms of manner and magnitude. In general, Cambodia still finds it difficult to take advantage of the ACFTA due to a lack of technology, investment capital, and human resources, and the non-availability of local suppliers of production materials.

The final section considers necessary policy actions to exploit the export opportunities brought about by the ACFTA and regional trade agreements in general. Six specific suggestions can be extrapolated from the detailed analysis in the previous sections. The recommendations are classified into two groups. The first four recommendations are general in scope, with exports to the PRC expected to increase significantly if these recommendations were implemented properly. But if the status quo persists, exports to the PRC are not likely to increase significantly because of a range of constraints that Cambodian industries face. The final two recommendations are related to policies toward the ACFTA and these steps necessary to maximize the potential benefits of this agreement.

Recommendation 1: Simplification of trade procedures and eradication of unofficial fees. All exporting industries in Cambodia are faced with sophisticated, costly, and time-consuming export procedures, as well as high logistics and transportation costs. The government needs to reduce bureaucratic constraints in the export process to encourage the private sector to fully harness its potential capacity to export. In addition, the government should establish a single-window service for all procedures related to the export process. All of the firms interviewed raised concerns about the high unofficial

²⁶ See footnote 1.

facilitation fees required to export their products. The government needs to deal with this issue seriously by enforcing the newly adopted anti-corruption law, setting up an effective monitoring mechanism, and improving law enforcement. The private sector, especially exporting firms, should be given direct access to senior leaders of the relevant anti-corruption units. Only through partnership and cooperation between the public and private sectors, can these unofficial fees be reduced. What should be noted is that burdensome export procedures and corruption are inter-related. Some officials prefer the single export permits over multiple export permits because they can collect unofficial fees more frequently. Thus, simplifying trade procedure is an effective way to reduce corruption.

Recommendation 2: Hard infrastructure and logistics services development. Hard infrastructure (particularly road and railway) connectivity needs to be improved. Public institutions and development partners need to strategically identify and develop hard infrastructure to facilitate increased exports. Exporters tend to use Vietnamese ports instead of the Sihanoukville because the related transport costs are cheaper and the process less time consuming. In addition, the private sector should invest more in logistics services, while the deregulation of investments in the transportation sector is strongly encouraged.

Recommendation 3: Human resources development and capacity building for exporting firms. Underdeveloped human resources is the main constraint facing exporting firms. In the food industry, human resources are extremely limited, especially in the field of production engineering and management science, which are critical to reducing costs and guaranteeing international standards of quality. Manpower in agricultural engineering and laboratory and scientific research are required to increase crop productivity and develop the agro-industry in a sustainable way, given that Cambodian agricultural products still have very low value-added. Development partners should implement more projects to support the productivity of agricultural exporting firms in Cambodia. Capacity building projects within the private sector should be encouraged and further developed.

Recommendation 4: Establishment of local suppliers, supporting industries, and a value chain. The garment industry in Cambodia faces a serious lack of local suppliers such as fabrics producers. While some sectors in the industry are competitive, the industry as a whole is not competitive, because only a part of the value chain exists in Cambodia. Value chain creation within the production network is necessary for job and income generation. In relation to this, it is important to build up supporting industries. For example, Cambodia's food industry has not been competitive enough because firms need to use expensive imported packaging materials. It is not the process of food production itself, but rather the need to import packaging materials, that pushes up the cost of Cambodian food products. If inexpensive and high-quality packages were domestically produced in Cambodia, the Cambodian food industry could become more competitive and profitable. Thus, the government and development partners should support the establishment of local suppliers and other supporting industries.

Recommendation 5: Improvement in information dissemination with regard to international markets and FTAs. The government and development partners need to provide more information regarding regional trade agreements and offer support to the private sector in designing appropriate market entry strategies. Information on the benefits of using FTAs to enjoy preferential export treatment should be widely disseminated among Cambodian exporters, including SMEs. Rigorous market research on international markets for Cambodian exporters is also necessary. In many cases, Cambodian firms face difficulty in exporting to other countries, including the PRC, simply because of a lack of market information. Weak commercial networks, especially international networks, are another critical problem. Instead of directly exporting to the PRC, Cambodian firms sometimes need to export to intermediaries in other countries that have commercial connections with the PRC. In addition, the private sector should be encouraged to participate more in regional trade agreement dialogues to enable them to raise their concerns.

Recommendation 6: Improvement in the quality of Cambodian products through upgraded technology. The food industry in Cambodia lacks international quality standards. It is necessary for public institutions and development partners to assist the private sector, especially exporting firms and factories, to improve the quality of their products. Technology transfer also contributes significantly to the improved quality of their products and to production capacity as well. Foreign direct investment and foreign–local business partnerships will encourage increased technology and knowledge transfer, which can contribute significantly to the development of infant industries in Cambodia. The import of machinery with the latest technology is also very important. Some subsectors of the agriculture sector, such as cotton production, have been enjoying tariff-free imports of machinery from the PRC under the ACFTA, resulting in increased productivity. If tariffs on machinery other than agricultural-related machinery were also to be reduced equally under the ACFTA framework, it would contribute to higher productivity among Cambodian industries.

References

- Coalition to Address Sexual Exploitation of Children in Cambodia (COSECAM) and Plan Cambodia. 2009. Comparative Industry Assessments. *Cambodian Commodity Chain Analysis Study*. Volume 1. http://www.cosecam.org/publications/cambodia_commodity_chain_analysis_study_volume1_eng.pdf.
- S. Ear. 2009. Sowing and Sewing Growth: The Political Economy of Rice and Garments in Cambodia. *Working Paper*. 384. Stanford, CA: Stanford Center for International Development.
- Government of Cambodia. 2005. *Report of the Royal Government Subcommittee on SMEs*. Phnom Penh, Cambodia.
- S. Hamanaka. 2011. Multiple Mirror Technique for Quality Assessment of Trade Statistics: The Preliminary Assessment of Cambodia's Case. *ADB Working Paper Series on Regional Economic Integration*. Manila: Asian Development Bank. Forthcoming.
- S. Kobayashi, H. Tanji, K. Saito, W. Huang, and M. Tada. 2009. Industrial Structure of Cambodia and the Role of Agriculture and Fishery in its Development. *Japan Agricultural Research Quarterly*. 43 (4). pp. 309–316.
- United States Agency for International Development (USAID). 2006. SME Statistics in Cambodia. http://www.usaid.gov/kh/documents/Report_SME_Statistics_English_Bound%20_23_Jan_08.pdf
- T. Yamagata. 2006. *The Garment Industry in Cambodia: Its Role in Poverty Reduction through Export Oriented Development*. http://ir.ide.go.jp/dspace/bitstream/2344/131/5/ARRIDE_Discussion_No.062_yamagata.pdf

Annex: Questionnaire for the Project—The Impacts of Regional Trade Arrangements on Cambodian Industries²⁷

I. Background of the company

- Name of respondent
- Name of firm
- Type of products
- Number of regular employees
- Year of firm establishment
- Type of firm: 1. Fully owned multinational. 2. Fully owned domestic firm. 3. Fully owned foreign firm. 4. Foreign–domestic Joint Venture Firm

II. Questions

- Do you know about Cambodia's free trade agreements with other countries and regions? (A. Yes or B. No); If you choose A, please specify the types of agreement.
- Do you know about the Association of Southeast Asian Nations (ASEAN)–[People's Republic of] China Free Trade Agreement, which is also referred to as the ACFTA? (A. Yes or B. No)
- Do you think that the Cambodian government has widely disseminated the ACFTA to the private sector? (A. Yes or B. No or C. Do not know)
- Have your companies gotten involved with any free trade negotiations so far? (A. Yes or B. No or C. Do not know); If you choose A, please specify number of times your company has been involved:
- Has there been any structural change within your company in recent years, such as revenues, market, and production network? (A. Yes or B. No); If you choose A, please specify what kinds of changes has your company made?
- Who are your suppliers? From which countries or regions do they originate?
- Who are your main customers? Do you export your products to the People's Republic of China (PRC)?
- Do you have any plans to export to ASEAN and the PRC? How you will do this?
- What are the sources of your company's raw materials? Do you have any difficulty in importing those materials?
- Which countries does your company import technologies and machines from? Do you have any difficulty in importing these technologies and machines?
- Do you have any plans to form joint ventures with foreign firms?
- Have the import, export, and production processes of your company as a whole improved recently? What kinds of problems has your company faced with the above processes?
- What are the main constraints of your company in exporting the products or services to other countries in the region, especially the PRC?
- Could your products and/or services compete with Chinese products in the Cambodian market? Why?
- What are you going to do to increase your company's competitiveness against Chinese products or services?
- What kinds of help do you need from the Cambodian government in order to boost your company's competitiveness against products and/or services from foreign countries, especially the PRC?

²⁷ The format is changed from the original.

ADB Working Paper Series on Regional Economic Integration*

1. “The ASEAN Economic Community and the European Experience” by Michael G. Plummer
2. “Economic Integration in East Asia: Trends, Prospects, and a Possible Roadmap” by Pradumna B. Rana
3. “Central Asia after Fifteen Years of Transition: Growth, Regional Cooperation, and Policy Choices” by Malcolm Dowling and Ganeshan Wignaraja
4. “Global Imbalances and the Asian Economies: Implications for Regional Cooperation” by Barry Eichengreen
5. “Toward Win-Win Regionalism in Asia: Issues and Challenges in Forming Efficient Trade Agreements” by Michael G. Plummer
6. “Liberalizing Cross-Border Capital Flows: How Effective Are Institutional Arrangements against Crisis in Southeast Asia” by Alfred Steinherr, Alessandro Cisotta, Erik Klär, and Kenan Šehović
7. “Managing the Noodle Bowl: The Fragility of East Asian Regionalism” by Richard E. Baldwin
8. “Measuring Regional Market Integration in Developing Asia: a Dynamic Factor Error Correction Model (DF-ECM) Approach” by Duo Qin, Marie Anne Cagas, Geoffrey Ducanes, Nedelyn Magtibay-Ramos, and Pilipinas F. Quising
9. “The Post-Crisis Sequencing of Economic Integration in Asia: Trade as a Complement to a Monetary Future” by Michael G. Plummer and Ganeshan Wignaraja
10. “Trade Intensity and Business Cycle Synchronization: The Case of East Asia” by Pradumna B. Rana
11. “Inequality and Growth Revisited” by Robert J. Barro
12. “Securitization in East Asia” by Paul Lejot, Douglas Arner, and Lotte Schou-Zibell
13. “Patterns and Determinants of Cross-border Financial Asset Holdings in East Asia” by Jong-Wha Lee
14. “Regionalism as an Engine of Multilateralism: A Case for a Single East Asian FTA” by Masahiro Kawai and Ganeshan Wignaraja

15. "The Impact of Capital Inflows on Emerging East Asian Economies: Is Too Much Money Chasing Too Little Good?" by Soyoung Kim and Doo Yong Yang
16. "Emerging East Asian Banking Systems Ten Years after the 1997/98 Crisis" by Charles Adams
17. "Real and Financial Integration in East Asia" by Soyoung Kim and Jong-Wha Lee
18. "Global Financial Turmoil: Impact and Challenges for Asia's Financial Systems" by Jong-Wha Lee and Cyn-Young Park
19. "Cambodia's Persistent Dollarization: Causes and Policy Options" by Jayant Menon
20. "Welfare Implications of International Financial Integration" by Jong-Wha Lee and Kwanho Shin
21. "Is the ASEAN-Korea Free Trade Area (AKFTA) an Optimal Free Trade Area?" by Donghyun Park, Innwon Park, and Gemma Esther B. Estrada
22. "India's Bond Market—Developments and Challenges Ahead" by Stephen Wells and Lotte Schou- Zibell
23. "Commodity Prices and Monetary Policy in Emerging East Asia" by Hsiao Chink Tang
24. "Does Trade Integration Contribute to Peace?" by Jong-Wha Lee and Ju Hyun Pyun
25. "Aging in Asia: Trends, Impacts, and Responses" by Jayant Menon and Anna Melendez-Nakamura
26. "Re-considering Asian Financial Regionalism in the 1990s" by Shintaro Hamanaka
27. "Managing Success in Viet Nam: Macroeconomic Consequences of Large Capital Inflows with Limited Policy Tools" by Jayant Menon
28. "The Building Block versus Stumbling Block Debate of Regionalism: From the Perspective of Service Trade Liberalization in Asia" by Shintaro Hamanaka
29. "East Asian and European Economic Integration: A Comparative Analysis" by Giovanni Capannelli and Carlo Filippini
30. "Promoting Trade and Investment in India's Northeastern Region" by M. Govinda Rao

31. "Emerging Asia: Decoupling or Recoupling" by Soyoung Kim, Jong-Wha Lee, and Cyn-Young Park
32. "India's Role in South Asia Trade and Investment Integration" by Rajiv Kumar and Manjeeta Singh
33. "Developing Indicators for Regional Economic Integration and Cooperation" by Giovanni Capannelli, Jong-Wha Lee, and Peter Petri
34. "Beyond the Crisis: Financial Regulatory Reform in Emerging Asia" by Chee Sung Lee and Cyn-Young Park
35. "Regional Economic Impacts of Cross-Border Infrastructure: A General Equilibrium Application to Thailand and Lao PDR" by Peter Warr, Jayant Menon, and Arief Anshory Yusuf
36. "Exchange Rate Regimes in the Asia-Pacific Region and the Global Financial Crisis" by Warwick J. McKibbin and Waranya Pim Chanthapun
37. "Roads for Asian Integration: Measuring ADB's Contribution to the Asian Highway Network" by Srinivasa Madhur, Ganeshan Wignaraja, and Peter Darjes
38. "The Financial Crisis and Money Markets in Emerging Asia" by Robert Rigg and Lotte Schou-Zibell
39. "Complements or Substitutes? Preferential and Multilateral Trade Liberalization at the Sectoral Level" by Mitsuyo Ando, Antoni Esteveordal, and Christian Volpe Martincus
40. "Regulatory Reforms for Improving the Business Environment in Selected Asian Economies—How Monitoring and Comparative Benchmarking can Provide Incentive for Reform" by Lotte Schou-Zibell and Srinivasa Madhur
41. "Global Production Sharing, Trade Patterns, and Determinants of Trade Flows in East Asia" by Prema-chandra Athukorala and Jayant Menon
42. "Regionalism Cycle in Asia (-Pacific): A Game Theory Approach to the Rise and Fall of Asian Regional Institutions" by Shintaro Hamanaka
43. "A Macroprudential Framework for Monitoring and Examining Financial Soundness" by Lotte Schou-Zibell, Jose Ramon Albert, and Lei Lei Song
44. "A Macroprudential Framework for the Early Detection of Banking Problems in Emerging Economies" by Claudio Loser, Miguel Kiguel, and David Mermelstein
45. "The 2008 Financial Crisis and Potential Output in Asia: Impact and Policy Implications" by Cyn-Young Park, Ruperto Majuca, and Josef Yap

46. "Do Hub-and-Spoke Free Trade Agreements Increase Trade? A Panel Data Analysis" by Jung Hur, Joseph Alba, and Donghyun Park
47. "Does a Leapfrogging Growth Strategy Raise Growth Rate? Some International Evidence" by Zhi Wang, Shang-Jin Wei, and Anna Wong
48. "Crises in Asia: Recovery and Policy Responses" by Kiseok Hong and Hsiao Chink Tang
49. "A New Multi-Dimensional Framework for Analyzing Regional Integration: Regional Integration Evaluation (RIE) Methodology" by Donghyun Park and Mario Arturo Ruiz Estrada
50. "Regional Surveillance for East Asia: How Can It Be Designed to Complement Global Surveillance?" by Shinji Takagi
51. "Poverty Impacts of Government Expenditure from Natural Resource Revenues" by Peter Warr, Jayant Menon, and Arief Anshory Yusuf
52. "Methods for Ex Ante Economic Evaluation of Free Trade Agreements" by David Cheong
53. "The Role of Membership Rules in Regional Organizations" by Judith Kelley
54. "The Political Economy of Regional Cooperation in South Asia" by V.V. Desai
55. "Trade Facilitation Measures under Free Trade Agreements: Are They Discriminatory against Non-Members?" by Shintaro Hamanaka, Aiken Tafgar, and Dorothea Lazaro
56. "Production Networks and Trade Patterns in East Asia: Regionalization or Globalization?" by Prema-chandra Athukorala
57. "Global Financial Regulatory Reforms: Implications for Developing Asia" by Douglas W. Arner and Cyn-Young Park
58. "Asia's Contribution to Global Rebalancing" by Charles Adams, Hoe Yun Jeong, and Cyn-Young Park
59. "Methods for Ex Post Economic Evaluation of Free Trade Agreements" by David Cheong
60. "Responding to the Global Financial and Economic Crisis: Meeting the Challenges in Asia" by Douglas W. Arner and Lotte Schou-Zibell
61. "Shaping New Regionalism in the Pacific Islands: Back to the Future?" by Satish Chand
62. "Organizing the Wider East Asia Region" by Christopher M. Dent

63. "Labour and Grassroots Civic Interests In Regional Institutions" by Helen E.S. Nesadurai
64. "Institutional Design of Regional Integration: Balancing Delegation and Representation" by Simon Hix
65. "Regional Judicial Institutions and Economic Cooperation: Lessons for Asia?" by Erik Voeten
66. "The Awakening Chinese Economy: Macro and Terms of Trade Impacts on 10 Major Asia-Pacific Countries" by Yin Hua Mai, Philip Adams, Peter Dixon, and Jayant Menon
67. "Institutional Parameters of a Region-Wide Economic Agreement in Asia: Examination of Trans-Pacific Partnership and ASEAN+ α Free Trade Agreement Approaches" by Shintaro Hamanaka
68. "Evolving Asian Power Balances and Alternate Conceptions for Building Regional Institutions" by Yong Wang
69. "ASEAN Economic Integration: Features, Fulfillments, Failures, and the Future" by Hal Hill and Jayant Menon
70. "Changing Impact of Fiscal Policy on Selected ASEAN Countries" by Hsiao Chink Tang, Philip Liu, and Eddie C. Cheung
71. "The Organizational Architecture of the Asia-Pacific: Insights from the New Institutionalism" by Stephan Haggard
72. "The Impact of Monetary Policy on Financial Markets in Small Open Economies: More or Less Effective During the Global Financial Crisis?" by Steven Pennings, Arief Ramayandi, and Hsiao Chink Tang
73. "What do Asian Countries Want the Seat at the High Table for? G20 as a New Global Economic Governance Forum and the Role of Asia" by Yoon Je Cho
74. "Asia's Strategic Participation in the Group of 20 for Global Economic Governance Reform: From the Perspective of International Trade" by Taeho Bark and Moonsung Kang
75. "ASEAN's Free Trade Agreements with the People's Republic of China, Japan, and the Republic of Korea: A Qualitative and Quantitative Analysis" by Gemma Estrada, Donghyun Park, Innwon Park, and Soonchan Park
76. "ASEAN-5 Macroeconomic Forecasting Using a GVAR Model" by Fei Han and Thiam Hee Ng

77. "Early Warning Systems in the Republic of Korea: Experiences, Lessons, and Future Steps" by Hyungmin Jung and Hoe Yun Jeong
78. "Trade and Investment in the Greater Mekong Subregion: Remaining Challenges and the Unfinished Policy Agenda" by Jayant Menon and Anna Cassandra Melendez
79. "Financial Integration in Emerging Asia: Challenges and Prospects" by Cyn-Young Park and Jong-Wha Lee
80. "Sequencing Regionalism: Theory, European Practice, and Lessons for Asia" by Richard E. Baldwin
81. "Economic Crises and Institutions for Regional Economic Cooperation" by C. Randall Henning
82. "Asian Regional Institutions and the Possibilities for Socializing the Behavior of States" by Amitav Acharya
83. "The People's Republic of China and India: Commercial Policies in the Giants" by Ganeshan Wignaraja
84. "What Drives Different Types of Capital Flows and Their Volatilities" by Rogelio Mercado and Cyn-Young Park
85. "Institution Building for African Regionalism" by Gilbert M. Khadiagala

*These papers can be downloaded from (ARIC) <http://aric.adb.org/reipapers/> or (ADB) http://adb.org/Economics/publications.asp?fs=fm_9:999

Impediments to Growth of the Garment and Food Industries in Cambodia: Exploring Potential Benefits of the ASEAN-PRC FTA

Using a qualitative case study method based on the firm-level interviews, this paper identifies structural constraints to growth and exports within Cambodia's garment and food industries and considers the policy actions needed to reduce obstacles to trade. A special emphasis is placed on Cambodia's exports opportunities to the People's Republic of China (PRC) under the free trade agreement between the Association of Southeast Asian Nations and the PRC.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.8 billion people who live on less than \$2 a day, with 903 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.