Background

Since the 1990s, and more recently with the establishment of the ASEAN Economic Community (AEC), trade liberalization and economic integration (both regional and international) have become top policy priorities for the Royal Government of Cambodia.

This strategy is integrated in a number of key national policy frameworks, with the stated objectives to create jobs, enhance economic growth and reduce poverty.

Research question and objectives

Meanwhile, by 2013, there had been no evidence produced from in-depth analysis to support these policy trends and claims - i.e. measuring the potential costs and benefits of increased trade liberalization for the Cambodian economy.

So the objective of this research team was to produce a rigorous assessment of the impacts of Cambodia’s trade liberalization - and related changes in fiscal policy - on growth, employment and poverty in the country.

More specifically, the researchers seek to identify the policy options that would help maximize the benefits and minimize the costs, while preparing the country for full trade liberalization.

Key findings

The following conclusions were made from the analysis of the simulation’s results.

At the macro level: Overall, tariff elimination leads to an expansion in production outputs and an increase in export/import volumes.

However, an indirect tax-led revenue compensation results in the change of structural production output, favoring the manufacturing industry over the agriculture and service sectors.

The textile industry continues to be the backbone for growth and employment over the short and medium term.

In terms of effects on labor market, low-skilled workers see relatively less benefit from tariff elimination.

At the micro level: Overall, welfare gains for the majority of households are positive, but small - the impacts on households’ income and consumption are almost the same.

The exceptions are those populations living in remote provinces - e.g. Kratie, Preah Vihear, Rattanakiri, Stung Treng - who experience a negative welfare effect from the simulations of tariff removal.

Those living in Phnom Penh are less affected by the indirect tax increase.

Data and methodology

CGE modeling and macro-micro policy simulations:

Step 1: Building the first Social Accounting Matrix (SAM) of Cambodia

Step 2: Building the first Computable General Equilibrium (CGE) model of Cambodia’s national economy

Step 3: Use this CGE model as a laboratory to conduct various simulations (of macro policies and shocks) and assess their impacts on a variety of outcomes, both at the macro and micro levels.

Two scenarios of trade liberalization policy:

Sim 1 - Complete tariff removal

Sim 2 - Complete tariff removal with increase in indirect tax rates imposed on commodities* - which is meant to compensate tariff revenue loss and in accordance with current government policy

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Policy implications

Based on these results, the researchers suggest the following policy measures to address the potential negative effects of tariff removal:

• Provide additional support to the agricultural sector, which is negatively affected by an indirect tax increase - e.g. through infrastructure development or tax exemption.

• Government can help low-skilled workers by providing training programs and exemption from new tax policy.

• Prioritize households of remote areas (such as Kratie, Rattanakiri, Preah Vihear and Stung Treng) in complementary policy interventions, e.g. social protection policies.

• Cambodia should also take serious consideration into tariff structure to encourage more economic activities and productivity growth in agriculture, which employs half of the country’s labor force.

<table>
<thead>
<tr>
<th>Output</th>
<th>Sim 1</th>
<th>Sim 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>0.04</td>
<td>0.11</td>
</tr>
<tr>
<td>Exports</td>
<td>0.94</td>
<td>0.97</td>
</tr>
<tr>
<td>Imports</td>
<td>1.34</td>
<td>1.50</td>
</tr>
<tr>
<td>Investment</td>
<td>6.29</td>
<td>3.26</td>
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<tr>
<td>Consumption</td>
<td>1.15</td>
<td>-0.44</td>
</tr>
<tr>
<td>Consumer price</td>
<td>-0.74</td>
<td>-0.61</td>
</tr>
</tbody>
</table>

*which is meant to compensate tariff revenue loss and in accordance with current government policy - which is meant to compensate tariff revenue loss and in accordance with current government policy.