

# PEP impact brief

## Cambodia

Assessing the impacts of trade liberalization on growth, employment and poverty

2013-2014

### Project milestones

- May 2013 Participation in intensive PEP training workshop in CGE modeling, South Africa
- June 2013 Selection of project proposal for PEP support
- June 2013 Team organizes the first of a series of consultation meetings with national policy stakeholders and advisors,
- Sept. 2013 Team leads a CGE training workshop for government staff, sponsored by UNICEF
- May 2014 Presentation of research findings and final report at PEP general meeting in Bolivia
- Sept. 2014 Presentation of research findings at ADB-3iE international conference, in Manila
- Nov. 2014 Team organizes a “policy roundtable” to share findings with major national policy stakeholders, in Phnom Penh
- March 2015 Publication of findings as a PEP working paper



### Context

As it prepares for the establishment of the ASEAN Economic Community (end of 2015), trade liberalization and economic integration (both regional and international) have become top policy priorities for the Royal Government of Cambodia in recent years.

This strategy has been elaborated in a number of national policy frameworks, with the stated objectives to create jobs, enhance economic growth and reduce poverty. And yet, as of 2013, no evidence from any in-depth analysis had been produced to support such policies, i.e. no analysis measuring the potential costs and benefits of increased trade liberalization for the Cambodian economy.

In view of this important knowledge gap, a team of local researchers sought PEP support 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.

#### Local research team

**Dyna Heng**, project leader – Cambodian Economic Association  
**Senh Senghor** – Cambodian Economic Association  
**Kagna Em** – Cambodian Economic Association  
**Sokrachany Ngim** – Royal University of Law and Economics  
**Sothy Ear** – Cambodia Ministry of Industry, Mines and Energy  
**Theary Chan** – Cambodia Ministry of Economy and Finance

#### PEP mentors and trainers

**Bernard Decaluwe**  
**Erwin Corong**  
**Helene Maisonnave**

#### PEP publications

Working paper 2015-08  
 Policy brief 123

# Producing a reliable evidence base to inform ongoing national policy debates

Despite positive claims from the policy side, there is ongoing debate in Cambodia as to whether the country is ready for full trade liberalization; especially given its low-skilled labor force and limited infrastructure.



## Key findings and conclusions from the locally-led policy analysis project

This PEP-supported study aimed to produce reliable evidence regarding the actual effects (and their significance) of the national policy trend towards trade liberalization on economic growth, employment and poverty reduction in the country. The researchers also sought to identify the policy options that would help maximize the benefits and minimize the costs, while preparing the country for full trade liberalization.

The research team used a CGE model of the Cambodia economy - built with the support of PEP mentors (see page 3) - to simulate the effects of tariff elimination on various sectors and dimensions of the national economy, including those related to welfare at the household level. Two different scenarios were simulated; one including the implementation of a government policy to increase indirect taxes to compensate for losses in trade-related tax revenues, and the other without such policy (no tax increase).

**At the macro level,** results from the simulations show that, overall, tariff elimination leads to an expansion in production outputs and an increase in export/import volumes. A government policy for indirect tax-led revenue compensation results in the change of structural production output, favoring the manufacturing industry over the agriculture and service sectors.

Those “favoured” manufacturing industries include textiles, raw metals, fabricated metals, and office and computing machinery. The effects of tariff removal favour the textiles industry as it is presently less protected and consumes a large proportion of now cheaper intermediate inputs. This industry will continue to be the backbone for growth and employment over the short and medium term. In terms of effects on labor market,

low-skilled labourers see relatively less benefit from tariff elimination.

**At the micro level,** the impacts on households’ income and consumption are almost the same. Those living in Phnom Penh are less affected by the indirect tax increase and, overall, welfare gains for the majority of households are positive, but small. 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.

***Tariff elimination leads to an expansion in production output and an increase in export/import volumes. Government policy for indirect tax-led revenue compensation results in the change of structural production output, favoring the manufacturing industry, versus the agricultural and services sectors.***

***Overall, the gains in terms of welfare at the household level are positive but small, except for populations living in remote areas, for whom the effect is negative.***

**Based on these results, the research team suggests the following policy measures to address the negative side effects of tariff removal :**

- Efforts to aid the agricultural sector – e.g. via infrastructure development and tax exemption
- Support low-skilled workers by providing training programs and/or tax exemption
- Social protection policy/programs should prioritize households living in remote areas.

Cambodia should also take serious consideration into tariff structure to encourage more economic activities and productivity growth in agriculture, which is employing half of the labor force.



# Building and promoting new tools and expertise for policy analysis in Cambodia

## CGE modeling and policy simulation techniques

In order to produce such evidence, the team first had to build a computable general equilibrium (CGE) model of Cambodia's national economy (structure, features, constraints, etc). CGE models are meant to serve as a laboratory to conduct simulations of macro shocks/policies, and assess their impacts on a variety of outcomes in a given country.

A priori, and as a prerequisite of such methodology, the researchers also had to build the first Social Accounting Matrix (SAM) of Cambodia.

In both cases, and as the first of their kinds, these tools were to become major assets for the advancement of development research and policy analysis in the country. Similarly, the expertise built by the research team in the application of such advanced methods is a major leap for the national scientific community.

In addition to funding, all PEP-supported research project teams benefit from intensive training activities (at the onset of the project), access to related resources (recommended readings, training materials, software tools, etc.), a unique international peer-review experience, as well as ongoing mentoring and technical support provided by PEP mentors (world leading experts in relevant research methods/areas) all throughout the project lifecycle.

Thanks to this new expertise, the project team leader, Dyna Heng, was appointed president of the Cambodian Economic Association in January 2014. He was also the first Cambodian economist to be invited to participate in the IMF Economist Program, in Washington DC, in September 2014.

Other team members have also been offered important positions at the Ministry of Economy and Finance, as well as in major banks and think tanks.

*"My knowledge, experience, and confidence on the analysis of macroeconomic issues and sectoral interactions, built through the PEP study, have helped me be selected out of 1500 PhD applicants from around the world".*

- Dyna Heng

Over the course of the project, several consultation meetings held with government agencies and other institutions (see page 3), at the national level, have contributed to raising keen interest in the researchers' new expertise and the potential uses of the CGE model they have developed.

As a result, UNICEF agreed to sponsor a training workshop (led by the PEP research team) in CGE modeling and related techniques, for economists at the Ministry of Economy and Finance (MEF) and the Supreme National Economic Council (SNEC) – both

institutions are thus currently building their capacity in the CGE methodology, to promote evidence-based policymaking in Cambodia.

The research team members have also been asked by some of these institutions (e.g. the Ministry of Labor and Vocational Training) to lead new research projects using the same tools and methods, while UNICEF has advocated for the application of the new CGE tools to analyze the impact of fiscal policies and public spending on child welfare in the country.

# Engaging with key national policy makers, advisors and stakeholders

## To maximize chances of research uptake

All throughout the project lifecycle, the research team has engaged and consulted with those institutions identified as most direct potential users of the expected research findings – including the Supreme National Economic Council (SNEC), the Ministry of Commerce, the Ministry of Planning, the Ministry of Economy and Finance, the National Institute of Statistics, as well as other relevant institutions, such as UNICEF-Cambodia.

The SNEC, in particular, is a highly strategic audience, as the top economic think tank for the Royal Government of Cambodia and most influential institution for national economic policymaking, with direct access to the Prime Minister.

As mentioned on page 3, these meetings and discussions have, on the one hand, contributed to raising keen interest, amidst those institutions, for the researchers' new expertise and the analytical tools they have developed - both of which are now increasingly involved in policy advisory processes at the national level.

On the other hand, such continual engagement and communication activities have contributed to ensuring that the research findings would in fact be used to inform relevant policy debates and decisions.

## National policy roundtable to discuss PEP findings

On November 28, 2014, the research team organized a special "policy roundtable", in Phnom Penh, to officially present and discuss the main findings and related policy implications of their analysis (described on page 2) with key policy makers and stakeholders.

The event attracted several high-level officials from the Cambodia government - including the Minister of Commerce himself – as well as strategic policy advisors and representatives from the public and private sectors (Chamber of Commerce, National Bank of Cambodia), international institutions (IMF, UNICEF) and civil society organizations.

Discussions and comments shared during this event suggest that the project's findings and conclusions will serve to inform strategic policy decisions and initiatives in Cambodia, especially in the context of the establishment of the ASEAN Economic Community in 2015. The Minister of Commerce, in particular, committed to take account of the research findings in regards to any potential negative impact of trade policies in the agriculture sector, and the need for related policy responses.

Overall, the participants were very impressed by the quality and relevance of the PEP project, and some stressed the importance of its contribution in building a bridge between the government and the research community in Cambodia.



September 2014  
ADB headquarters  
Manila, Philippines

The team is invited to present its PEP research work and findings during the international conference: "Making Impact Evaluation Matter: Better Evidence for Effective Policies and Programmes", organized jointly by the Asian Development Bank and 3iE



November 2014  
Sofitel, Phnom Penh  
Cambodia

The Cambodia Minister of Commerce and other stakeholders discuss the implications of the PEP research work and findings, during a special "policy roundtable" organized by the research team.

