

# Re-examining the Determinants and Constraints of Cambodia-China's Trade Connectivity

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## Introduction

Trade between Cambodia and China particularly has kept expanding since the first trade agreement signed in 1996, according to the China-ASEAN Center. By 2014, China was the third largest market for Cambodia's products after the EU and the US, which accounted for approximately 17.2% of Cambodia's total exports. Moreover, China's exports to the country accounted the biggest proportion, at 32.6% of the total import values (WTO, 2015).

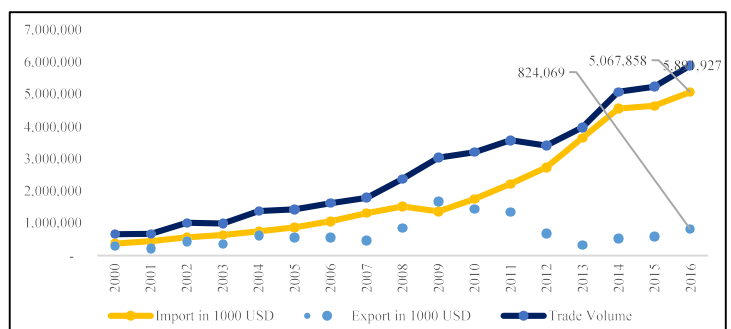
The World Integrated Trade Solution (WITS) provided by the World Bank allows users to query several international trade databases such as trade statistics (exports, imports, re-exports and re-imports) from UN COMTRADE, tariff and non-tariff measures (NTM) data from UNCTAD TRAINS and tariff and bound tariff information from WTO, IDB and CTS databases. Data from the WITS shows that Cambodia has been strongly integrated into the world market. Moreover, the country's openness to trade has been also significant. In the last one and a half decades, trade between Cambodia and all her trading partners has accounted for more than 100 percent of the country's GDP. Cambodia has experienced more imports than exports. In 2016, the export of goods and services accounted for 61% of the GDP while the import accounted for 66% of the GDP, resulting in a trade deficit close to 5%.

## Trend and Pattern of Trade between Cambodia and China

The United States was the largest export market,

followed by European countries such as the United Kingdom and Germany in 2016. Japan and Canada also ranked in the top ten export destination of Cambodia in the same year. China, nevertheless, has also been one of the top trading partners with Cambodia, ranking as the 6th largest export destination for Cambodia's products and the largest importer to Cambodia. The total volume of trade with China—including mainland China, Hong Kong and Macao—accounted for almost USD 6 billion, of which the import volume was around USD 5 billion and the export volume was still minimal, accounting for USD 824 million in 2016. In the last five years, trade with mainland China has increased rapidly. Trade with mainland China accounted for about USD 5.1 billion in 2016 raising from USD 4.3 billion in 2015 while trade with Hong Kong accounted for about USD 730 million in 2016 slightly dropping from USD 896 million in 2015. Trade between Cambodia and Hong Kong has, in fact, been declining in the last three years while trade with Macao has been at so minimal volume.

Figure 1: Total Export and Import with the Three Regions of China



Source: Extracted from the World Integrated Trade Solution (WITS) provided by the World Bank, 2018

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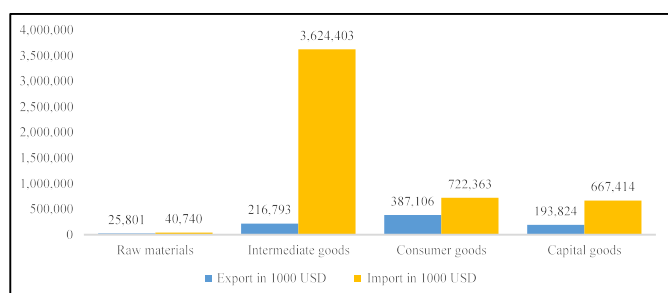
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This policy brief is from the research project funded by the Cambodia 21st Century Maritime Silk Road Research Center.

Trade between Cambodia and China still has been highly concentrated on few sectors. Classifying the traded products by two digit shows that the top three products exported to China in 2016 were textiles and clothings, machines and electronic products, and hides or skin products, all of which combined represented more than 80% of the total export volumes. On the other hand, the products imported from China to Cambodia in the same year was excessively concentrated on textiles and clothings, followed by machines and electronic products.

The value of imports has been much larger than the value of exports. Moreover, textiles and clothings and machines and electronic products appeared to be the top products included in both imports and exports. Examining these patterns tends to suggest that Cambodia's trade with China has been mostly in the same sectors; in other words, the intra-trade pattern seems to have come into existence in trade activities between these two countries. The decomposition of traded products according to its stage of processing (SoP) as consumer goods, intermediate goods, capital goods, and raw materials suggests that Cambodia's largest share of imports from China was in intermediates goods, accounting for about USD 3.6 billion in 2016 while her largest share of export to China was in the form of consumer goods. Moreover, the trade in industrial goods has far exceeded that in agriculture. The export of industrial goods decreased from 2009 to 2012 and increased again after 2013. The export of agricultural products to China appeared to increase from 2012. However, the import of industrial products has been rising tremendously since 2000.

Figure 2: Trade in consumers, intermediate, raw material and capital goods in 2016



Source: Extracted from the World Integrated Trade Solution (WITS) provided by the World Bank, 2018

## Main findings and Discussion

Trade flow between Cambodia and China is affected by the main drivers described as follows. Firstly, the economic size of the two countries positively and statistically significantly affects the trade flow, suggesting that as the economic size of both countries grows bigger, the trade flows are likely to increase too. The results are consistent with the studies of other scholars such as Sohn (2005) and Huot and Kakinaka (2007). Secondly, the impact of the exchange rate on trade connectivity is statistically negative. The results suggest that exchange rate fluctuation has a negative impact on trade flow, consistent with the explanation that uncertainty about exchange rate negatively affects trade flow. Thirdly, enhancement of transportation has been found to have a positive and statistically significant impact on trade connection. This simply explains that as the infrastructure improved the trade of Cambodia with China also increases.

Fourth, the magnitude drawn from the variables FDI and ODA seems to suggest as expected. FDI inflows seem to have a positive and statistically significant impact on trade flows although the finding does not really suggest the direction on which trade flows it impacts. Nevertheless, the finding by Heng (2014) reveals that the positive net inflows of FDI are found positively related to both exports and imports in Cambodia. ODA is found to have a positive relationship with trade connectivity, yet not statistically significant. Last but not least, index of economic freedom and its five selected components of the two countries, which include government integrity, financial freedom, trade freedom, business freedom, and tax burden freedom, all have positive and statistically significant impacts on trade exchange.

## Policy Recommendations

In order for Cambodia to enjoy and sustain the benefits from trade connectivity with China in the medium and long run, some policy recommendations have been made as follows.

1. First of all, Cambodia should push for more volume of export to China to enhance its trade balance, yet intensify and diversify its supply of intermediate goods within the focused traded industries domestically, either invested by foreign firms or domestic firms, to exploit more benefits in trade.
2. Secondly, Cambodia will have to take advantage from the currently growing traded sectors (both import and export) with China as an engine to diversify Cambodia's export to the rest of the world by establishing linkage to other potential industry to increase employment to sustain long-term growth. Especially, given the marginal gain contributed from garment sector is slowing down, there is a need to enhance the linkage to other industries to boost other high value-added industries as soon as possible.
3. Third, Cambodia still has to enhance its efficiency and competitiveness by reducing cost contributed by the non-trade barriers such as delay in export procedures, logistic performance and infrastructure, and customs clearance procedure.
4. Cambodia has to continue strengthening its political and economic stability as it is a vital part of the motives to build confidence and commitment among the good investors—not only Chinese but also other nationalities—to promote the economic prosperity of the nation and trade relation of Cambodia with China as well as the rest of the world. Cambodia has been endowed by moderately good economic freedom, yet among the five selected

- components, the government integrity index is still moderately low, scoring 21 out of 100 in 2016. This indicates that Cambodia still needs to improve the government integrity, in particular, honest government officials.
5. Last but not least, as the stability of macroeconomic factors has been found to have positive impacts on trade connectivity reflected by the necessity of foreign exchange rate stabilization, Cambodia through the monetary policy of the royal government should continue stabilizing the foreign exchange market. Uncertainty of exchange rate may not only bring about the negative effect on trade exchanges but also could possibly push the country to fail in building confidence among potential investors coming in as well.






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