

CHAPTER 1

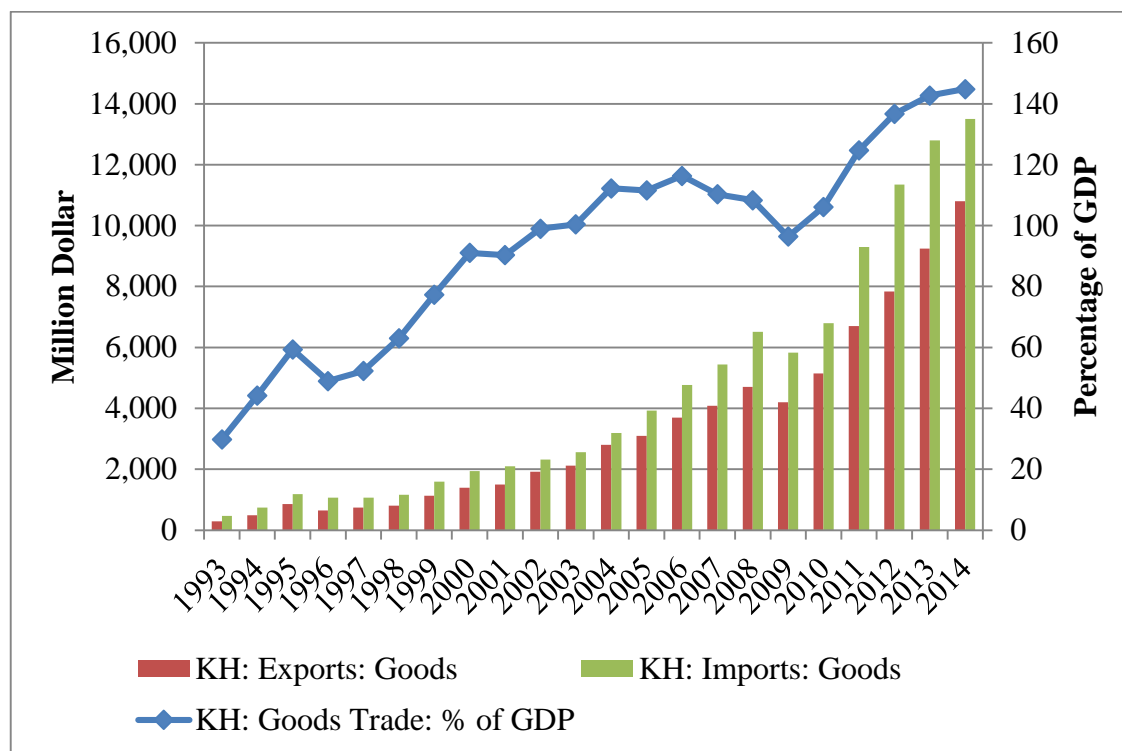
Introduction

1.1 Principle and Rationale of the Study

Over the last two decades Cambodia economy was completely destroyed to zero ground. Especially market, trade, and relative economic activities were cut off during the Khmer rouge regime in the period of 1975 to 1979 (Peou & Clayton, 2001). After the fall of Khmer Rouge regime in 1979, Cambodia starts restructuring the country's economy system. Cambodia had adopted economy model from Vietnam, which all the economic activities were directly controlled by the government rather than free market (Chheang & Wong, 2012). Historically, the first General election in Cambodia in 1993 brought peace and stability in the country. Since then, Cambodian economy has fully changed from command economy to free-market economy. Political stability and economy reforms have made the Cambodian economy gradually grow, yet the growth was caused to fall by the Asian Financial crisis in 1997 (Atinc & Walton, 1998).

Subsequently, Cambodia has become a member of Association of South East Asian Nation (ASEAN) in April 1999. The aim of being an ASEAN member is to stabilize, to prosper and to increase a competitive ASEAN economic region in region. Mainly, the role ASEAN Free Trade Area (AFTA) is to promote a better economic efficiency, productivity, and competitiveness among member countries. The AFTA aims to eliminate tariff and non-tariff barriers under the idea of Common Effective Preferential Tariff (CEPT) scheme which requires reducing tariff to between 0% and 5%. In the ASEAN-6 countries include Brunei, Indonesia, Malaysia, the Philippines; Singapore, and Thailand, tariffs on 99% of the products in the CEPT Inclusion List have been reduced to zero tariff in 2010. For CLMV (Cambodia, Lao PDR, Myanmar and Vietnam), 97% tariffs in their Inclusion List have been cut down to less than 5%. There was around 99% of products in Inclusion List reduced to between 0% and 5%, while 95% of products for Lao PDR (Okabe & Urata, 2014). The low tariff rate or non-tariff

can increase the Cambodia's trade with ASEAN region. Likewise, Cambodia became a formal World Trade Organization (WTO) member on 13 October 2004, expected to be able to earn benefit from international trade.



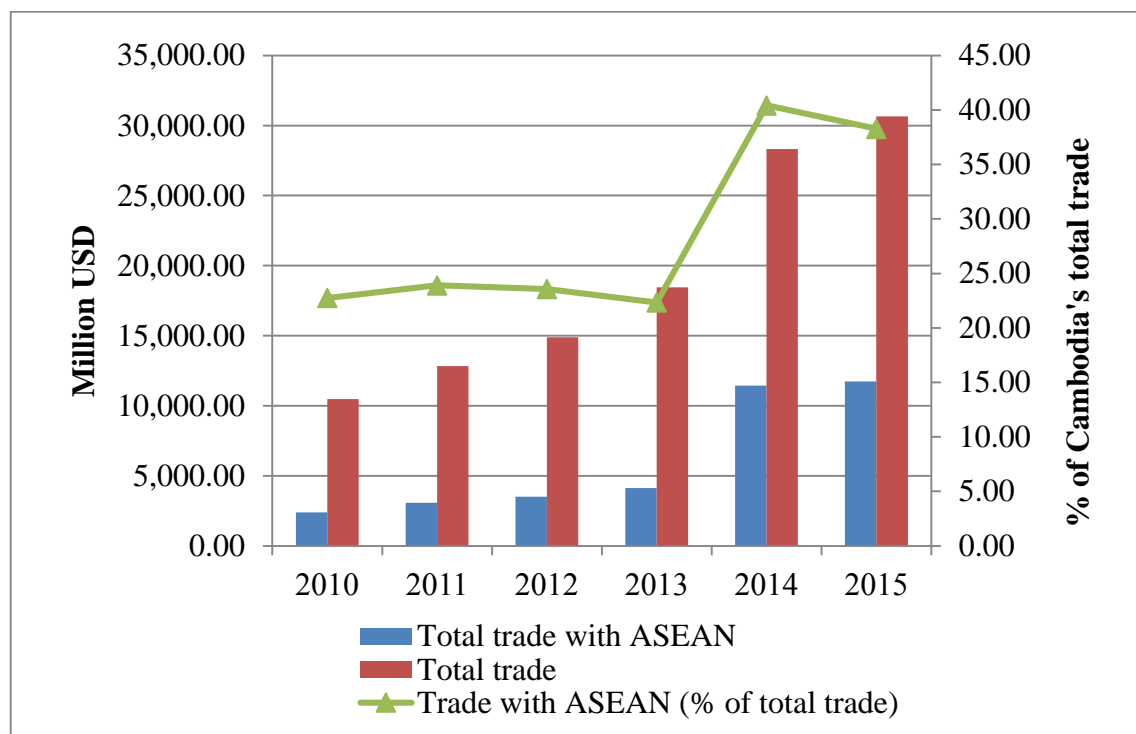
Source: CEIC Data Manager, World Bank WDI (2015)

Figure 1.1 The trend of Trade, Import and Export goods during 1993-2014

According to the report of International Monetary Fund (IMF), Cambodia's economy continued robustly with growth rate 7% in the last five years, and expected to stay sturdy with the growth rate 7% to 7.3% in 2015 and 2016. The economy growth of Cambodia is positively impacted by the foreign trade, real estate and construction.

The figure 1.1 shows the trend of trade as a percentage of GDP, import goods and export goods of Cambodia from 1993 to 2014. Even though Cambodia trade has been increasing, Cambodia was hurt by the trade deficit which its exports are much higher than its imports from 1993 to the present. Moreover, the curve of the trade as percentage of GDP shows in figure1.1 is the unsmooth growth of Cambodian trade. It was affected by Asian Financial Crisis (1997-1998) and the global financial crisis (2008-2009). Consequently, Cambodia trade has been rapidly growing from 2010 to 2014. Cambodia's export values of goods have increased from the year 1993 with the value

284 USD million to 10.8 USD billion in the year 2014, which is growing from 29% to 114% of GDP. On the other hand, importing value has been growing from USD 471 million in the year 1993 to USD 13.5 billion in the year 2014 (Figure 1.1).



Source: CEIC Data Manager, World Bank WDI (2015)

Figure 1.2 Total trade, and Trade with ASEAN (Million USD and % of total trade)

The total trade of Cambodia and its trade with ASEAN have been increasing gradually (figure 1.2). The Cambodia's total trade has been rising from 10,480.34 million USD (in 2010) to 30,648.10 million USD (in 2015). Significantly, the trade volume between Cambodia and ASEAN has been growing from 2,384.59 million USD to 11,731.88 million US in 2010 and 2015, respectively. The Cambodia's trade with ASEAN trend is significantly increasing from 22% of the Cambodia's total trade to almost 40% of its total trade in 2010 and 2015, respectively.

The table 1.1 shows Cambodia's major trading partners in ASEAN countries such as Thailand, Vietnam, Singapore, Indonesia, Malaysia, and Philippines. Thailand and Vietnam are the first and the second largest trading partners of Cambodia in ASEAN. Numerically, the Cambodia's bilateral trade values with Thailand and Vietnam are 5,951 million USD and 3,664 million USD in 2015, respectively; followed by

Singapore (1,198 million USD), Indonesia (491 million USD), Malaysia (395 million USD), and the Philippines (22 Million USD). Surprisingly, the Cambodia bilateral trade volume with these six countries is 11.724 billion USD, while its bilateral trade with the whole ASEAN region is 11.732 billion USD. Its bilateral trade with these six countries contributes 99.9% of the total trade in the whole ASEAN region.

On the other hand, There are only few papers study on the Cambodia's trade flows such as Huot and Kakinaka (2007), Kim (2006), and Heng (2014). However, those studies did not cover the specific gravity model for Cambodia's bilateral trade with ASEAN countries which is unable to demonstrate the determinant factors influence trade between them. These are the reasons why this paper should be done to analyze the bilateral trade between Cambodia and ASEAN countries using gravity model. The study will answer two major questions as following:

1. Firstly, what are determinant factors affecting on bilateral trade between Cambodia and its trading partners in ASEAN?
2. Secondly, what is the predicted potential and performance of Cambodia's bilateral trade between Cambodia and its trading partners in ASEAN?

Table 1.1 Cambodia's trade with its major trading partners in ASEAN during 2002-2015, (Million USD)

Year	Thailand	Vietnam	Singapore	Indonesia	Malaysia	Philippines	Six countries	ASEAN
2002	246.31	130.83	148.99	78.51	81.31	1.78	687.74	690.33
2003	227.70	158.36	148.86	83.99	94.19	2.32	715.43	716.34
2004	248.47	211.05	154.98	80.15	86.70	6.49	787.84	788.60
2005	305.80	227.72	205.78	83.83	101.03	7.81	931.97	933.26
2006	430.19	345.04	295.85	86.97	96.62	9.22	1,263.88	1,265.40
2007	530.88	427.83	311.81	91.11	115.21	7.62	1,484.45	1,486.08
2008	710.18	642.43	417.24	101.10	131.43	6.25	2,008.63	2,011.02
2009	486.36	608.50	690.61	149.70	146.04	14.24	2,095.46	2,097.43
2010	839.83	582.75	585.00	179.26	184.76	10.00	2,381.60	2,384.59
2011	916.63	1,031.37	679.69	175.53	254.85	9.56	3,067.63	3,070.45
2012	1,004.69	1,053.67	943.10	223.77	265.21	15.77	3,506.21	3,512.76
2013	1,329.93	1,094.80	1,141.49	258.20	269.84	21.36	4,115.61	4,122.71
2014	5,461.01	3,501.55	1,454.60	474.40	433.79	112.34	11,437.69	11,445.10
2015	5,951.15	3,664.03	1,198.92	491.89	395.74	22.39	11,724.12	11,731.88

Source: CEIC Data Manager (WDI), Chiang Mai University

1.2 Purpose of the study

There are two major purposes in the study of factors affecting bilateral trade between Cambodia and its trading partners in ASEAN:

1. First is to identify the determinant factors influencing the bilateral trade between Cambodia and its trading partners in ASEAN by using gravity trade model.
2. The second purpose is to predict the potential trade and performance of bilateral between Cambodia and its trading partners in ASEAN using Absolute Differences Index and Relative Differences Index.

1.3 Advantage of the study

The study will greatly benefit to international traders, the ministry of Economic and Commerce and the Cambodia government. The results of the study will be vital information for policy maker to conduct a positive policy for facilitating and promoting bilateral trade between Cambodia and its trading partners in ASEAN. Moreover, the study will build a fundamental knowledge base on determinant factors that impact on the bilateral trades between them for the policy makers and related institutions to stimulate international trade growth as well as providing a reference source for further studies.

1.4 The Scope of study and data collection

The scope of this study focuses only the bilateral trade between Cambodia and its major trading partners in ASEAN except Lao PDR, Myanmar, and Brunei.

In investigating the factors affecting the bilateral trade between Cambodia and its major trading partners in ASEAN, the study employed the panel data framework with the gravity trade model. The yearly panel dataset of bilateral trade between Cambodia and its trading partners, and other factors affecting the bilateral trade between them are compiled from CEIC Manager database, Chiang Mai University and World Development Indicator (WDI), World Bank in the period of 1995 to 2015. The geographical distance is measured in kilometers of the distance between the capital city of Cambodia (Phnom Penh) to capital city of its trading partners was obtained from Centre d'Etudes Prospectives et d'Informations Internationales (CEPII).