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Cambodia-China FTA: Unlocking ‘China-plus Cambodia Concept’ on the Global Value Chains

*KHOV Ea Hai**

Executive Summary

- ❖ Amidst the Covid-19 pandemic and despite the EU's partial withdrawal of the EBA, Cambodia still managed to conclude and sign its comprehensive bilateral Free Trade Agreement (FTA) with China.
- ❖ By comparing with ASEAN-China agreements on trade in goods, trade in services, and investment signed separately, Cambodia-China FTA has been consolidated into a single package of agreement that allows a smooth transaction of trade, business and investment upon entry into force of the agreement.
- ❖ Cambodia-China FTA is an opened door for Cambodia to obtain about 98% of the world's total market access of the world's second-largest economy and the most populous country in the world, while only liberalised 90% of its full market access for China.
- ❖ With a complimentary comparative advantage, Cambodia-China FTA has established the China-plus Cambodia concept on the global value chains that are essentially serving the two countries' interests.

* KHOV Ea Hai is a research fellow at the Center for Governance Innovation and Democracy of the Asian Vision Institute (AVI).

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- ❖ ចំពេលនៃជំងឺកូវីដ១៩ និងការដកហូតដោយផ្នែករបស់សហភាពអឺរ៉ុបលើប្រព័ន្ធអនុគ្រោះពន្ធគយគ្រប់យ៉ាងលើកលែងតែសភាវុធក៏ដោយ ក៏កម្ពុជានៅតែអាចសម្រេចបានប្រកបដោយជោគជ័យ និងចុះហត្ថលេខាលើកិច្ចព្រមព្រៀងពាណិជ្ជកម្មសេរី (FTA) ទ្វេភាគីរបស់ខ្លួនដែលទូលំទូលាយ ជាមួយភាគីចិន។
- ❖ បើប្រៀបធៀបនឹងកិច្ចព្រមព្រៀងពាណិជ្ជកម្មសេរីអាស៊ាន-ចិនស្តីពីពាណិជ្ជកម្មទំនិញ ពាណិជ្ជកម្មសេវាកម្ម និងវិនិយោគដែលបានចុះហត្ថលេខាដាច់ដោយឡែកពីគ្នា កិច្ចព្រមព្រៀងពាណិជ្ជកម្មសេរីកម្ពុជា-ចិនបានប្រមូលបញ្ចូលគ្នាឱ្យទៅជាកញ្ចប់តែមួយនៃកិច្ចព្រមព្រៀងទាំងនោះដែលនឹងអាចអនុញ្ញាតឱ្យប្រតិបត្តិការពាណិជ្ជកម្ម ធុរកិច្ច និងវិនិយោគមានលក្ខណៈល្អប្រសើរនៅពេលចូលជាធរមាននៃកិច្ចព្រមព្រៀងនេះ។
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- ❖ ជាមួយនឹងឧត្តមភាពប្រៀបធៀបដែលអាចបំពេញអោយគ្នាទៅវិញទៅមក កិច្ចព្រមព្រៀងពាណិជ្ជកម្មសេរីកម្ពុជា-ចិនបានបង្កើតនូវទស្សនវិស័យចិនបូកកម្ពុជា នៅលើខ្សែច្រវាក់ផលិតកម្មពិភពលោកដែលមានសារៈសំខាន់ក្នុងការបម្រើដល់ផលប្រយោជន៍នៃប្រទេសទាំងពីរ។

Introduction

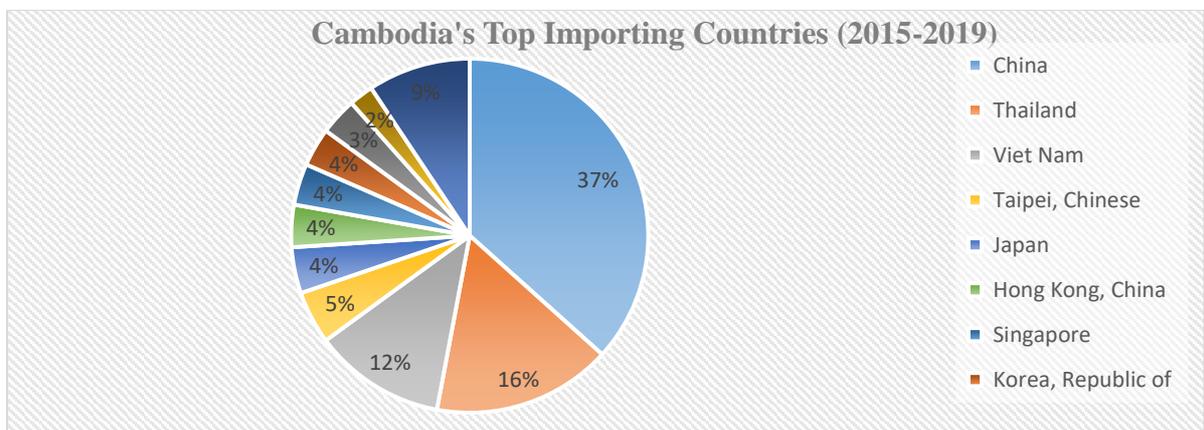
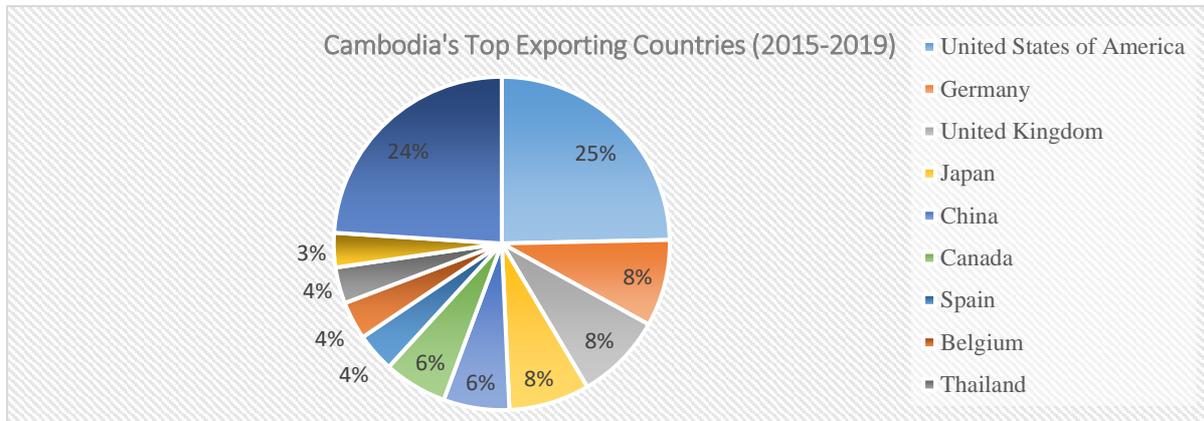
Over the past years, the world has undergone profound economic and political changes. Countries worldwide experience potential downside risk coming from the infamous policies of unilateralism and protectionism and the emergence of the Covid-19 crisis, which continue to disrupt the global supply chains and the livelihoods of people, at least for the foreseeable future. In the Cambodia's context, despite the Covid-19 pandemic and the EU's partial withdrawal of the EBA, Cambodia still managed to successfully conclude and sign its first bilateral free trade agreement (FTA), namely the Cambodia-China FTA. Both countries had negotiated for a remarkably short period, starting its first round of negotiation in Beijing in January 2020, concluding the negotiation virtually in July, and signing the agreement in October of the same year. It is expected to enter into force by 2021 after completing the domestic procedures to ratify the agreement by both parties. In this regard, by obtaining a large share of market access from the world's second-largest economy and the most populous country globally, it can be interpreted as one of the key milestone achievements of the Cambodian government. This article, therefore, aims to examine the significance of Cambodia-China FTA, the implications of Cambodia-China FTA on the potential "China-Plus Cambodia" concept in terms of global value chains, and its significance for policy discussion.

The Essence of Cambodia-China FTA

At the time of global uncertainty, the signing of this bilateral agreement has essentially reflected a firm commitment of Cambodia and China in rejecting protectionism and unilateralism. Both countries support multilateralism and market liberalisation that contribute to the prosperity of both countries and the world. For Cambodia, having the FTA with China comes as no surprise. Both countries have enjoyed a long history of traditional friendship, which has been upgraded to a comprehensive strategic cooperation partnership. The year 2020 marked the 10th Anniversary of the comprehensive strategic partnership between the two countries, so the signing of the agreement demonstrates the shared goals between Cambodia and China.

By examining the recent economic cooperation between the two countries, China has been one of Cambodia's top trading partners and also a major investor in Cambodia over the past five years. It continues to play an important role in trade in the coming future. From 2015 to 2019, China is the 5th largest exporting destination and the 1st largest importing country among Cambodia's top ten trading partners (see Figure 1 and Tables 1 and 2 in the Annex for more details).

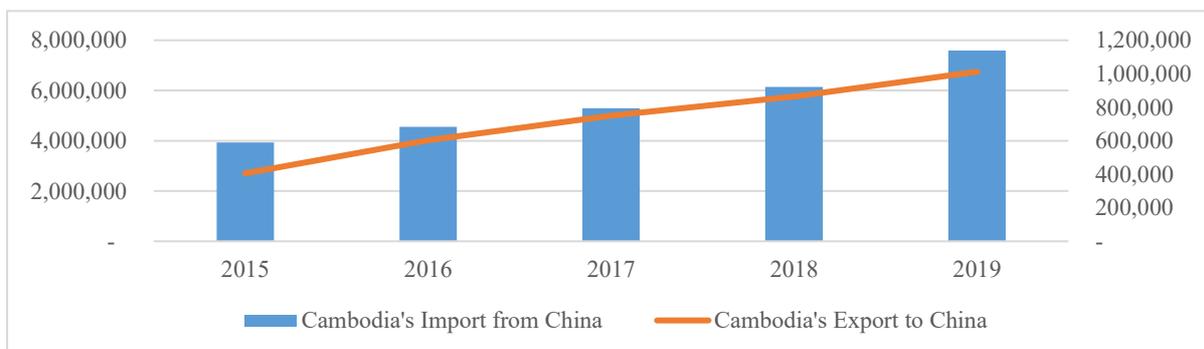
Figure 1: Cambodia's top ten trading partners (2015–2019)



Source: Adapted by the author based on the data from Trade Map (2015–2019).

The total bilateral trade flow of the two countries remarkably soared up over the five-year period. China's export to Cambodia's market increased almost double from USD 3,926 million in 2015 to USD 7,585 million in 2019. Meanwhile, Cambodia's export to China's market also experienced an increasing trend by doubling its trade value from USD 405 million in 2015 to USD 1,012 million in 2019 (see Figure 2 and Table 3 in the Annex for more details).

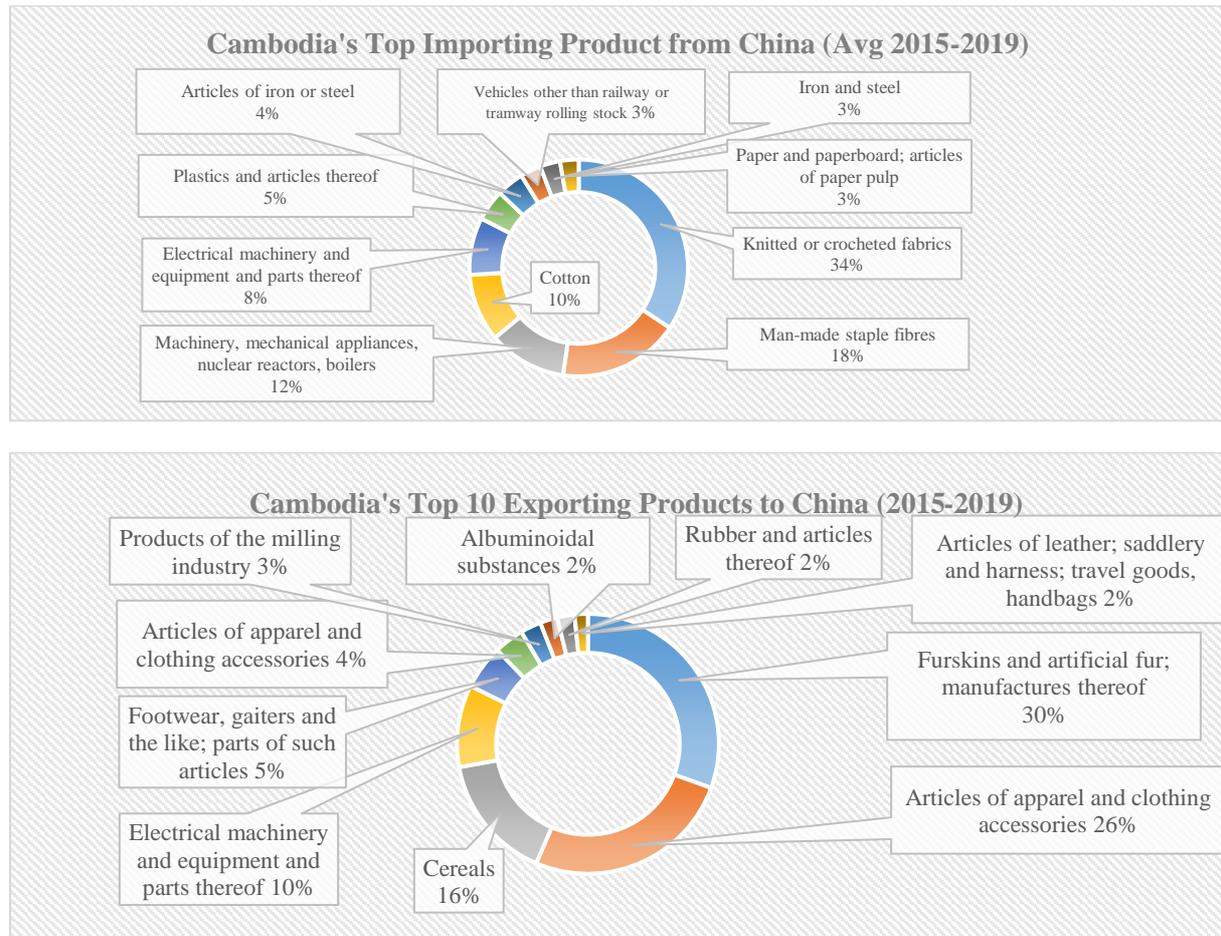
Figure 2: Bilateral trade flow between Cambodia and China (2015–2019), USD thousand



Source: Adapted by the author based on the data from Trade Map (2015–2019).

Cambodia mostly imports raw materials from China to feed its domestic industries' production, including knitted or crocheted fabric, man-made staple fibers, machinery, cotton, iron and steel, and paper. Meanwhile, Cambodia largely exports fur-skins and artificial fur, apparel and clothing accessories, cereals, electrical machinery and equipment parts, footwear and clothing accessories, milling industry products, albuminoidal substance, rubber and articles, and pieces of leather.

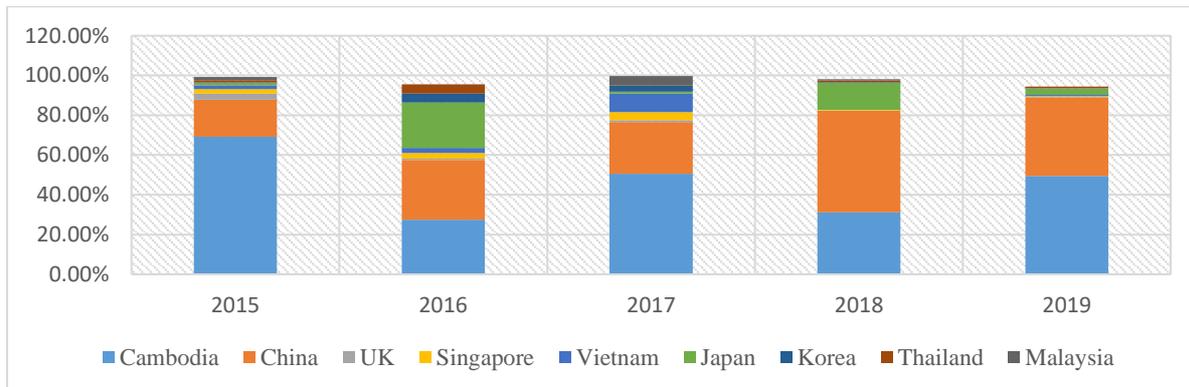
Figure 3: Top ten exporting and importing items between Cambodia and China



Source: Adapted by the author based on the data from Trade Map (2015–2019).

In the investment area, China has also been one of the key sources of FDI (Foreign Direct Investment) inflow and has helped drive major sectors, including tourism and construction. From 2015 to 2019, China was the largest investor among all the foreign investors in Cambodia (see Figure 4 and Table 6 in the Annex for more details). Nevertheless, it is not only for the period of these five years that China has been a major investor. Yet, the information from the CDC has confirmed that the cumulative FDI approved from 1994 to 2019, China alone has accounted at least 21.81%, which is the largest share among all in various fields, including infrastructure, resource development, and tourism (CDC 2020).

Figure 4: Investment trend in Cambodia (2015–2019)



Source: Adapted by the author based on the data from the Council for the Development of Cambodia.

In this regard, the entry into force of the Cambodia-China FTA certainly provides potential opportunities to both countries to further broaden and deepen their economic integration and trade relations. Since the first round of negotiation, both parties have made it clear that the agreement would lay down a foundation for comprehensive cooperation, including trade in goods, trade in services, investment, rules of origin, customs procedures and trade facilitation, technical barriers to trade, sanitary and phytosanitary, economic and technological cooperation, and last but not least the Belt and Road Initiative (BRI) (MoFCOM 2020). Therefore, the FTA is viewed as a comprehensive and modern agreement that is vertically and horizontally constructed merging cross-cutting sectors into a single package of a free trade agreement. Under the ASEAN-China framework, the ASEAN-China agreements for trade in goods, trade in services and investment are technically separated and stand-alone agreements, which entered into force with different timeframes: in 2004, 2007 and 2009, respectively. The entry into force of the single package of agreement with other sectors allows a smooth operation of trade, business and investment to take its full maximum benefits from the FTA, as given the fact that in reality, the economic activities are intertwined and interconnected across different sectors and means.

On top of that, it is possibly the first FTA that has synergised with cooperation under the BRI. Yet, the synergy with the BRI is nothing new to Cambodia as reflected in the Rectangular Strategy Phase IV, which is the most important guiding strategic development document of the Royal Government of Cambodia, which has been consolidated from various sectoral development strategies, national strategic development plan and other policy documents (RGC 2018, 5 and 19). The FTA also reaffirms that both countries intend to promote their cooperation beyond the infrastructure connectivity; such as building highways, airports, seaports, and railways; and other areas, including investment, trade, development policy synergy; and people-to-people connectivity.

According to Cambodian Chief Negotiator’s press conference on 28 July 2020, Cambodia offered 90% of its tariff lines to China while receiving about 98% of tariff lines from China in return (Thou 2020). This reflects two important things. First, the gap of trade liberalisation level between both countries has indicated China's flexibility to Cambodia. Cambodia remains one of the Least-Developed Countries, which means the production capacity is somehow less sophisticated than China. So flexibility is the Special and Differential Treatment that Cambodia deserves to receive. Second, that level of liberalisation in terms of tariff lines up to 90% shows

that the Cambodia-China FTA is the most liberal FTA compared with those that Cambodia has with ASEAN's current partners: 85.52% with Australia-New Zealand, 84.45% with South Korea, 82.90% with India and 83.19% with Japan (Khov 2020, 5). Simultaneously, Cambodia has also received the largest percentage in terms of market access for exporting into China and compared with other China's bilateral FTAs that China ever signed. Based on China FTA Network, market access that China's trading partners received in their bilateral agreements, just to name a few: 93.9% with Georgia, 96% with the Maldives, 96.3% with Mauritius, 91% with Korea, and nearly 96% with Iceland (MoFCOM 2018, 2017, 2015, and 2014).

Unlocking 'China-plus Cambodia Concept' on the Global Value Chains

The FTA between the two countries is not a one-way beneficial trading arrangement; it comes with a complimentary competitive advantage with strategic interests involved. The two countries have different stages of economic development. Cambodia, one of the Least-Developed Countries, still has plenty of room for investment and potentials for growth as the country is reaping the demographic dividend. Cambodia's population is young and dynamic. The working-age group of people from 15 to 64 will remain the largest group until 2048, with a very small margin of dependency ratio of old people, as projected by the National Population Policy.

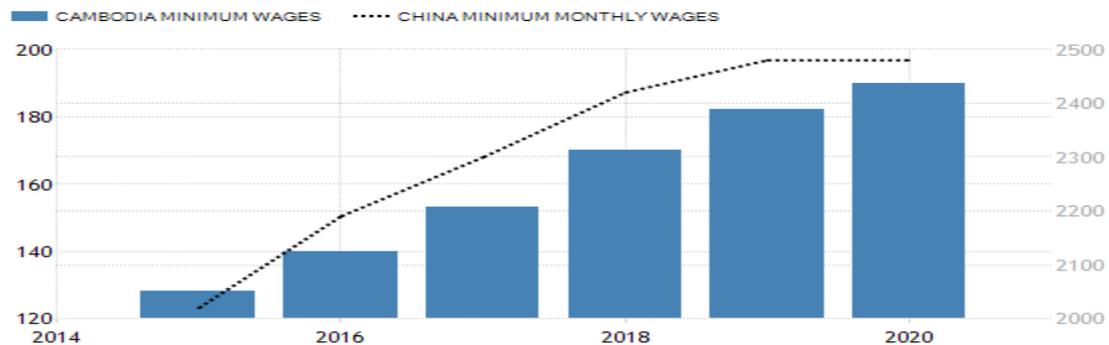
Table 1: Trends in dependency ratio, Cambodia

Age group	1998	2008	2018	2028	2038	2048
0-14	42.8	33.7	28.5	25.9	22.1	20.8
15-64	53.7	62.0	66.5	67.3	68.8	67.9
65+	3.5	4.3	5.0	6.9	9.1	11.3
Total	100	100	100	100	100	100
Dependency Ratio-overall	86.1	61.2	50.3	48.7	45.4	47.2
Dependency Ratio-Young	79.7	54.3	42.8	38.5	32.1	30.6
Dependency Ratio-old	6.4	6.9	7.5	10.2	13.3	16.6

Source: National Population Policy of Cambodian from 2016–2030.

While in China, the labour cost starts to soar up, so the labour-intensive industries need to outsource to remain competitive by investing partially or wholly in other less developed countries than China. Although the minimum wages in China vary between provinces and cities, yet in general, the hourly minimum wages have experienced an increasing trend with the perspective to grow further (Koty and Zhou, 2020).

Figure 5: Comparison of minimum wages between Cambodia (in USD) and China (in CNY)



Source: Trading Economics, tradingeconomics.com.

Additionally, the US-China Trade War has, to some extent, affected the global and regional trade patterns, as some factories have to relocate themselves to other countries to avoid the tariff imposition by the US. Under TRUMP, the US administration accused China of currency manipulation, forced technology transfers, government subsidies, and violations of US sanctions (Gentile, Li, and Mariasingham 2020). Although there is no official position on China, some analysis argued that President Biden would remain tough on China and would unlikely ease the pressure on key issues, including bilateral trade (Global Time, 2020).

Whatsoever, China needs to relocate some production bases to other countries to avoid any unforeseen consequences caused by the rise of labour cost and any future trade tension with the West, in particular the United States. This strategy could potentially solve the problem of putting all the eggs in one basket.

As a result, Cambodia becomes one of the most favourable places. With the Cambodia-China FTA coming at the right time, it becomes a catalyst for the China-plus Cambodia concept on the global value chain to take shape faster. This leaves the door opened for Cambodia to strategically position itself in the global value chains and move to a higher value-added production-based economy, as both countries gain many mutual benefits from their cooperation.

First, China's business community has a great opportunity to invest in Cambodia by having a final assembly line in Cambodia with the importation of other necessary parts and components from China. Hence, the made-in-Cambodia products meeting the rules of origin under Cambodia's existing FTAs and GSP schemes can be exported and enjoy the preferential markets that Cambodia upholds.

Second, Cambodia can participate in China's global value chains by specialising in a niche segment of the supply chains that mother factories in China do not produce or have a higher cost than the products that originated from Cambodia. Under this arrangement, Cambodia's products serve as the parts and components that would assemble for the final accumulation in China for export. This eventually provides Cambodia opportunities to participate in China's global value chains and diversify exportation by-products, leading to more specialisation of new industries.

Third, in a more sophisticated production, Cambodia needs to catch up and participate in the existing network of global values chains by importing and/or exporting its parts and components to accumulate with other neighbouring countries in the region in which China has already been operating.

For the involvement of developing countries in GVCs, geography matters. The world seems to have three interconnected production hubs for the extensive trade in parts and components: one centred on the United States, one on Asia (China, Japan, Republic of Korea), and one on Europe (Especially Germany). [...] China aside, developing countries are generally on the periphery and tend to trade with the geographically close hub. Many developing regions are barely involved at all. (the World Bank 2017).

There are several important regional and sub-regional projects and initiatives on connectivity, including the Master Plan on ASEAN Connectivity, GMS Economic Corridors, and the Belt and Road Initiative, promoting greater connectivity between major cities, industrial hubs, and major trading centres through a pipeline of development projects and technical assistance. As Cambodia geographically situates at the centre of ASEAN regional and Mekong sub-regional connectivity with inter-linkages with China, it could serve as a central point for certain industrial accumulation with broad supporting industry and upstream and downstream supply chains for major industries for China's business community. Cambodia can become a regional and sub-regional production hub for exporting in the value chains networks.

What Needs to Be Done?

Having signed the agreement does not necessarily mean the end of tasks for Cambodia in finding a new marketplace for its producers and farmers. The government thereby needs to design a package of supporting policies to promote FTA utilisation by tackling various issues.

- **Measures related to transparency of market access**

The removal of tariff barriers has been addressed by the schedule of tariff commitments of both countries under the agreement. However, the lack of information and knowledge among the public in the field could potentially reduce the potentials for export. The accessibility and availability of such information to the public are significant for private entities to make use of it and prepare themselves ahead. This issue can be easily addressed through having a publicly accessible, user-friendly online platform that is regularly updated. Yet, the publication of tariff reduction schedules, which consists of both countries' technical product descriptions on an online platform, is insufficient. To make the maximum use of it, it requires a comprehensive, integrated system that provides at least other related information on the rules of origin and the product-specific rules under the FTA and the general procedures or specific requirements for both import and export. With the products' names classified into the Harmonized System (HS) codes with brief descriptions, the public and especially traders and producers would still find it difficult given the possibility of limited knowledge in this area. Therefore, it is essential to establish a permanent unit or secretariat in charge, equipped with adequate resources to provide necessary technical consultations to medium and small enterprises, update and respond to inquiries from traders, producers and investors.

- **Non-tariff measures**

There are still many things that need to be done, especially in non-tariff measures, including technical barriers to trade and sanitary and phytosanitary. The agreement has significantly liberalised tariff barriers to a 0% rate for certain products originating from Cambodia. Still, it would not be able to export if the quality of the products does not meet the standards and other requirements imposed by China's authorities. The inability to comply with non-tariff measures in place and the lack of facility in a laboratory to certify its products could become the new barriers for Cambodia's producers and farmers to export their goods to China's market. However, the tariff rate is 0%. It is a need for the government's intervention to assist local producers and farmers in meeting the requirements for export. However, with the limited resources in terms of financial and technical supports, the potential products for promoting for exports have to be identified and prioritised in a list of core strategic products to ease the efforts in mobilising assistance for the target productions and firms.

- **Trade facilitation**

To either promote greater participation into global value chains or to boost the flow of exporting products into China's market, trade costs need to be addressed through trade facilitation measures to cut down to the maximum possible on cross-border-trade fees, time and collaboration of procedures and related documents that exporters are facing. Although only large firms can participate in the global value chains, any substantial reforms or incentive scheme for promoting trade facilitation to reduce trade costs shall be extended beyond the Special Economic Zones that have designated for large firms to the nationwide scale for the medium and small firms to enjoy the benefits of those reforms and incentive schemes and to be able to develop themselves to become local supporting industries of the production process. This localisation shall be one of the key policy objectives to participate in the global value chains. Importantly, those trade facilitation measures require regular monitoring and assessment on implementing those measures to make sure that they remain robust.

- **Coordination issues**

To tackle the lack of information, non-tariff measures and trade facilitation issues, the establishment of an inter-ministerial mechanism for the promotion of export under FTA and other preferential markets is imperative and necessary to address these cross-cutting sectoral issues arising during the implementation of the agreement and to oversee the annual progress of the FTA and other preferential markets utilisation. The function of this mechanism should not only play a crucial role in addressing coordination issues but also in the monitoring and assessment framework for formulating and revising the supporting policies for facilitating trade, incentivising investment and promoting localisation.

- **Investment law and its flexibility**

Cambodia has to accelerate its efforts in finalising its revision of the investment law to attract potential investors from China and other countries by providing a decent amount of incentives to invest in Cambodia. Incentive schemes provided by the revised investment law will allow the investors to revise their business plans for their future direction and decisions whether their investments will remain profitable in the country. It will also determine the types of industries, specific stages of the production process, and whether the investors have to move up to higher

value-added parts of the production process. In the rapidly changing world, there is also a need to have some sorts of flexibilities to modify the targeted industries and to adjust the incentive schemes as quickly as possible to capture any potential opportunity arising from the sudden changing nature of global value chains, for an instant, the relocation of firms from China to other countries under the context of the US-China trade war. The faster the country can act, the larger the share it can get.

- **Moving up value chains**

Cambodia, at this point, has to map out the current stage of its general involvement in the global value chains and the readiness of its private entities and its workforce in the context of the fragmentation of the international production process. Given the limited resources the country has, the option is to encourage more investment in joint ventures with foreign investors. This helps Cambodia begin its effort in specialising specific tasks within targeted sectors that Cambodia aims for in a value chain in a proportion of the overall value chains of a particular type of industries. It should be in joint ventures or some sort of investment models that ensure the feasibility of the government's medium-to-long-term intervention to allow enough time for transferring of technology; accumulating local raw materials, parts and components; contributing to the development of local supporting industries; and developing the system of before-and-after services. Such an intervention helps the country not only participate in the global value chains but also have the options for moving up higher value-added parts, given that to move up higher value-added parts is to upgrade labour skills, diversify products in the field to products with higher unit prices, improve the process of production methods toward innovation and new technologies, and move completely to a new field of global value chains.

The opinions expressed are the author's own and do not reflect the views of the Asian Vision Institute.

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Annex

Countries	Avg 2015–2019	Percentage
United States of America	2,827,395	25%
Germany	965,376	8%
United Kingdom	965,134	8%
Japan	891,688	8%
China	726,795	6%
Canada	700,972	6%
Spain	432,263	4%
Belgium	421,678	4%
Thailand	402,630	4%
France	382,905	3%
The rest	2,748,501	24%
Total	11,465,336	100%

Source: Extracted from Trade Map data 2015–2019, by country

Countries	Avg 2015–2019	Percentage
China	5,500,342	37%
Thailand	2,435,925	16%
Viet Nam	1,794,850	12%
Taipei, Chinese	722,382	5%
Japan	631,632	4%
Hong Kong, China	577,998	4%
Singapore	565,746	4%
Korea, Republic of	525,853	4%
Indonesia	507,133	3%
Malaysia	332,211	2%
The Rest	1,394,722	9%
Total	14,988,794	100%

Source: Extracted from Trade Map data 2015–2019, by country

	2015	2016	2017	2018	2019
Cambodia's Import from China	3,926,204	4,553,097	5,295,221	6,141,438	7,585,748
Cambodia's Export to China	405,515	602,563	750,430	863,317	1,012,148

Source: Extracted from Trade Map data 2015–2019, bilateral trade

Table 4: Cambodia's Top 10 Exporting Products to China, in USD thousand

Product label	Cambodia's Export in Avg 2015–2019	Cambodia's exports to China				
		2015	2016	2017	2018	2019
Furskins and artificial fur; manufactures thereof	196,422	115,044	147,190	245,953	220,965	252,960
Articles of apparel and clothing accessories, knitted or crocheted	166,963	102,964	138,659	183,273	212,472	197,449
Cereals	100,796	41,698	69,609	108,615	127,822	156,234
Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television ...	65,764	55,416	91,131	56,652	50,512	75,107
Footwear, gaiters and the like; parts of such articles	35,325	15,624	25,156	34,383	50,190	51,271
Articles of apparel and clothing accessories, not knitted or crocheted	23,787	6,238	9,375	9,760	27,414	66,150
Products of the milling industry; malt; starches; inulin; wheat gluten	16,501	7,609	10,564	15,297	28,669	20,366
Albuminoidal substances; modified starches; glues; enzymes	13,830	3,651	49,654	13,678	2,125	44
Rubber and articles thereof	13,699	6,033	10,350	4,583	22,523	25,005
Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles ...	10,549	1,835	3,266	3,557	15,529	28,557

Source: Extracted from Trade Map data 2015–2019, by product

Table 5: Cambodia's Top 10 Importing Products from China, in USD thousand

Product label	Cambodia's Import in Avg 2015-2019	Cambodia's imports from China				
		2015	2016	2017	2018	2019
Knitted or crocheted fabrics	1,410,268	1,174,641	1,284,147	1,430,681	1,609,228	1,552,643
Man-made staple fibres	738,182	680,434	716,440	736,934	779,946	777,157
Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof	475,347	341,628	386,106	395,259	495,455	758,289
Cotton	415,210	302,166	361,995	422,183	477,602	512,103
Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television ...	351,182	212,607	253,932	353,103	323,274	612,995
Plastics and articles thereof	190,802	94,479	143,967	159,491	219,449	336,622
Articles of iron or steel	166,330	57,410	115,158	126,240	171,805	361,039

Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	126,453	85,071	111,351	136,671	128,190	170,982
Iron and steel	121,862	52,743	76,787	97,228	137,240	245,312
Paper and paperboard; articles of paper pulp, of paper or of paperboard	112,827	60,400	88,742	114,909	126,715	173,370
Source: Extracted from Trade Map data 2015-2019, by Product						

Table 6: Investment Trend in Cambodia from 2015 to 2019

2015		2016		2017		2018		2019	
\$4.6 billion		\$3.6 billion		\$6.3 billion		\$6.4 billion		\$ 9.4 billion	
Country	%	Country	%	Country	%	Country	%	Country	%
Cambodia	69.28%	China	29.92	Cambodia	50.68	China	51.06	Cambodia	49.44
China	18.62	Cambodia	27.55	China	25.97	Cambodia	31.15	China	39.55
UK	3	Japan	22.78	Vietnam	9.2	Japan	13.69	BVI	4.93
Singapore	2.18	Thailand	4.61	Malaysia	4.37	Thailand	0.8	Japan	3.18
Vietnam	1.92	Korea	4.59	Singapore	4.12	BVI	0.76	Thailand	0.78
Malaysia	1.61	USA	3.38	Korea	3.2	Malaysia	0.68	Vietnam	0.7
Japan	1.28	Singapore	3.03	Japan	1	Samoa	0.67	Singapore	0.32
Thailand	1.18	Vietnam	2.45	UK	0.88	Singapore	0.28	UK	0.28
Korea	0.21	UK	0.6	Thailand	0.25	UK	0.23	Korea	0.22
Canada	0.19	India	0.55	Virgin Island	0.12	Korea	0.23	Holland	0.15
Others	0.53	Others	0.54	Others	0.21	Others	0.45	Others	0.45
Source: CDC, Investment Trend, cambodiainvestment.gov.kh									