Policy Brief

Cambodia's Graduation from Least Developed Country (LDC) Status: Preparedness and Potential Economic and Social Impacts

1. Graduation Prospects

Cambodia was included in the list of least developed countries (LDC) in 1991. Since then, Cambodia has achieved rapid socio-economic development and met the graduation criteria[1] for the first time in 2021. All three criteria were met again with significant margins in 2024.

In May 2024, the United Nations Economic and Social Council (ECOSOC) endorsed the recommendation for Cambodia's LDC graduation in 2029, following a five-year preparatory period. Graduation from LDC status, however, would result in the gradual withdrawal of international support measures including preferential trade arrangements, flexible application of the World Trade Organization's (WTO) Rules of Origin (RoO) and Trade-Related Aspects of Intellectual Property Rights (TRIPS), among others.

These changes will have implications on Cambodia's macroeconomic and trade performance (namely, export sectors), as well as on employment and poverty, with differential gender impacts.

2. Methodology

Considering this, the Royal Government of Cambodia (RGC) and UNDP conducted two studies to identify the potential socio-economic implications of the loss of international support measures on Cambodia. The following methods were applied:

- Partial equilibrium analysis to collate and assess export losses associated with the withdrawal of trade preferences.
- A calibrated Dynamic Global Trade Analysis Project (GTAP) Model[2] to estimate export losses.
- An integrated modelling approach encompassing the Dynamic Computable General Equilibrium (DCGE), employment matrix[3] and poverty model[4] applied to comprehensively assess the economic and social impacts of LDC graduation.

3. Cambodia Economy's SWOT Analysis

LDC graduation could exacerbate Cambodia's existing weaknesses and threats, but it could also create new opportunities by capitalizing on the country's strengths.

The Cambodian economy is vulnerable to external demand shocks and changing trade policies, and it may be further exposed following the LDC graduation. Weaknesses and threats include limited diversification due to limited backward linkages (linkages between industries and their suppliers) that capture the interconnectedness of industrial sectors and value chains, especially in Special Economic Zones (SEZs) where investors often source their inputs from abroad.

Cambodia's preferential market access to major trade partners, particularly the European Union (EU) and the United States (US), is conditioned by the application of human and labour rights and environmental and climate considerations. High cost of finance and logistics erodes the competitiveness of existing businesses and will likely affect the viability of new investments.

The comparatively high energy costs, infrastructure constraints, lack of specialised human capital, and limited technology and innovation capabilities further constrain Cambodia's ability to realize structural transformation to higher value-added and technology-based industrial development.

Provided that these risks are properly mitigated, Cambodia can utilize its strengths and opportunities to help consolidate its growth after LDC graduation. Cambodia will see some emerging benefits in the high-value-added agro-industry, diversifying industrial and export markets, high-quality infrastructure and digital technology, improving human capital and skills and domestic reforms that seeks to improve the business sector. These opportunities will accelerate growth in domestic private investment and enhancements in backward and forward linkages (or linkages between industries and their downstream markets), due to stricter trade compliance. The garment industry and agricultural exports also present opportunities for green trade.

[1]LDCs are assessed using the following criteria: income per capita, human assets and economic vulnerability. LDCs must meet two of the three eligibility criteria at two consecutive triennial reviews to be able to graduate.

[2]The Dynamic Global Trade Analysis Project (GTAP) Model as documented in Ianchovichina and McDougall (2000) was applied- Structure of Dynamic GTAP, GTAP Technical Paper No. 18, by Elena Ianchovichina and Robert McDougall. (Chapter 2). The Model was then calibrated using data from the version 10 database - Aguiar, A., Chepeliev, M., Corong, E., McDougall, R., & van der Mensbrugghe, D. (2019). The GTAP Data Base: Version 10. Journal of Global Economic Analysis, 4(1), 1-27.

[3]The 2020 Employment Satellite Matrix (EMSM), developed using sectoral employment characteristics from the 2019 Labor Force Survey (LFS), has been utilized to assess employment implications.

[4]A Poverty Model has been developed using the information of Cambodia Socio Economic Survey (CES) 2019. Household income and consumption generated in the SAM model are linked with this model to assess the poverty situation.

Figure 1. Strengths, Weakness, Opportunities and Threats (SWOT) of Cambodia's economy

Strengths	Weaknesses	Opportunities	Threats
1. Political and Macroeconomic stability	1. High cost of finance, production inputs, energy, and logistics	1. High value addition for agro-industry	1. Phaseout of trade preferences and develoment finance
2. Liberal trade and investment policy	2. Lack of highly skilled and productive workforce	2. Diversifying industrial and export's market	2. Concentration of industrial and export's market as well as foreign borrowing
3. Preferential access to Asia, EU and US markets	3. Weak institutions, enforcement of laws and regulations	3. Growing domestic consumption and investment	3. Lewis-turning point - shortage of labor and fall to "low-skill trap"
4. FTAs with regional and bilateral partners	4. Limited backward and forward linkages.	4. High quality infrastructure and digital technology adoption	4. Growing income inequality and social inclusion
5. Natural resources	5. Low domestic capacity for technology upgrading and innovation, especially SMEs.	5. Improving human capital and skills	5. Rapid urbanization and pollution levels
6. Young and affordable workforce, with a high internet adoption rate	6. Uneven playing field and high level of informality	6. Domestic reforms to improve business environment	6. Natural disasters and climate change vulnerability
7. Access to (multi)lateral development finances		7. Enhancing backward and forward linkages	
8. High women labour force participation			
9. Favorable geographical location for connectivity to global markets			

Source: Selected from various studies and policy discussions

4. Potential Impacts

4.1. Preferential Tariffs

LDC graduation will notably affect Cambodia's export sectors, including garment, rice, and bicycles to the European Union (EU) and Canada markets. The EU and Canada markets constituted 29.4% of the total exports in 2022, and the three export sectors to these markets accounted for 28.6% of the total exports in 2022[5].

The average tariffs will increase from 0% under EU's Everything but Arms (EBA) and Generalised Scheme of Preferences Plus (GSP+) to 8.8% under the standard Generalized System of Preferences (GSP) and to 11.5% under Most-Favored Nations (MFN) rates. Under the MFN rates, tariffs are also expected to rise for bicycles (10.1%) and other cycles (14.5%). Cambodia will also face significant increases in tariffs for rice under the GSP and MFN regimes, rising from EUR 0/ton to EUR 175/ton and EUR 65/ton for broken rice (fragmented, but not defective, rice that is broken in the field, during drying, transport, or milling). A s for Canada, most Cambodian exports qualify for zero tariffs under their preferential tariff scheme for LDCs (LDCT).

After graduation, Cambodia's exports to Canada would face up to 16.1% under Generalized Preferential Tariff (GPT) and 16.4% tariff under MFN rates for garment, textiles, footwear, and travel goods, 8.5% and 13.0% tariff, respectively, for bicycles, and 2.4% and 5.5% for other products.

4.2. Rules of Origin (RoO)

Following LDC graduation, stricter rules of origin will be applied to Cambodian exports to the EU, the United Kingdom, and Canada. Typically, a minimum local value added of 60% is required for preferential treatment, compared to 30% under LDC status. The lack of compliance will lead to higher MFN tariffs. In the garment sector, for example, double transformation is necessary for preferential treatment unlike the previous single transformation rule under the EU's GSP for LDCs.

4.3. Loss of Opportunities and Flexibilities Under the WTO Rules

After graduation, the LDC-specific benefits will cease. Only the general Special and Differential treatment for developing nations will be retained. Likewise, Cambodia will no longer be eligible for longer transition periods to implement the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), as LDCs are not required to comply with all provisions of the TRIPS Agreement until 1 July 2034 for full TRIPS

[5]The impact on the US market is expected to be minimal as most aforementioned exports are not covered by GSP. Similarly, the impact will be limited for ASEAN trade agreements.

Table 1. Potential average rise of tariffs after graduation

Product	Exporting Markets*	Current Effective Tariffs (%)	Average Tariff Faced (%)	
			Standard GSP/GPT	MFN
Garment, textile, footwear, and travel goods	EU (31%)	0	8.8 (0-GSP+)	11.5
	Canada (8%)	0	16.1	16.4
	US (40%)	11.5	9.8	11.5
Bicycles and other cycles	EU (49%)	0	10.1, (0-GSP+)	14.5
	US (37%)	8	7.33	8.0
	Canada (2%)	0	8.5	13.0
Rice	EU (38%)	0	EURO 175/ton and 65/ton for broken rice (0-GSP+)	EURO 175/ton and 65/ton for broken rice
	US (0.6%)	11.2 or US $140/ton, 44/ton for broken rice	5.6	11.2 for US $140/ton, 44/ton for broken rice
	Canada (0.1%)	0	0	0
All other products	EU (3%)	0	0.3 (0-GSP+)	0.3
	US (60%)	4.9	1.0	3.2
	Canada (1.4%)	0	2.4	5.5

Source: Calculated from Trade Map (2023) and WTO Tariff Database (2021), * percentage in the brackets are market shares.

Agreement compliance. Cambodia will lose the exemptions and flexibilities under Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures that prohibit export subsidies.

Upon graduation, Cambodia will lose extended transition periods and must comply with standard Trade-Related Investment Measures (TRIMs) rules, which certain investment measures that do not conform to the TRIMs Agreement, such as local content requirements and trade balancing measures, must be eliminated. Cambodia may also face less favourable conditions in the WTO-dispute settlement mechanism.

4.4. Development Cooperation

Graduation will further reduce access to development cooperation funding, shifting from grants to loans with less concessional terms. After graduation, Cambodia may lose access to grant-based funding and concessional loans, resulting in reduced Official Development Assistance (ODA). Cambodia is also likely to experience a shift to higher interest loans and may no longer benefit from debt relief, increasing the debt servicing burdens. The direct impact of ODA on GDP may be negligible for Cambodia. LDCs do benefit from support to participate in international organizations and processes through caps and discounts on contributions to budgets and support for travel to international meetings and others. After graduation, the LDC cap and the ability to contribute at the lowest classes of contribution no longer apply.

5. Socio-Economic Impact: Economy-Wide Modelling Approach

5.1. Trade Impacts Using GTAP

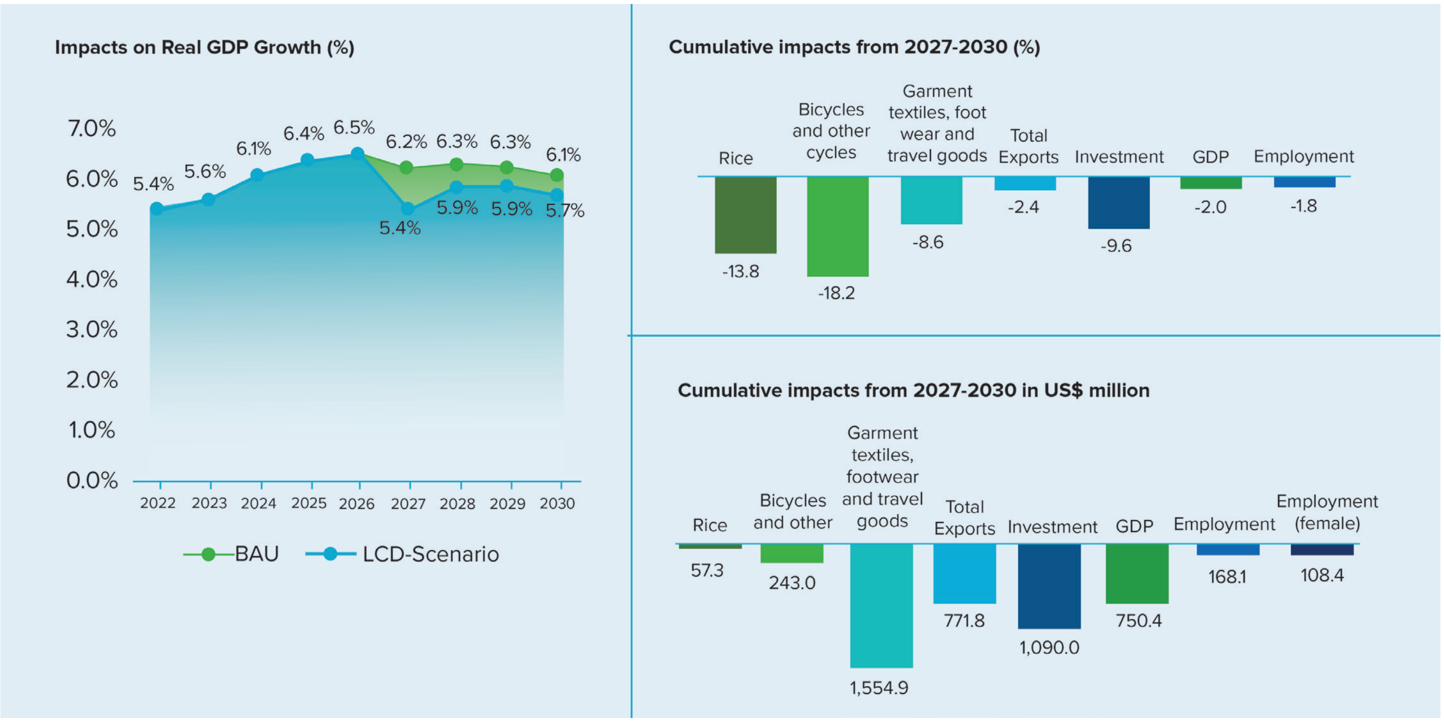
According to the Dynamic Global Trade Analysis Project (GTAP), the potential negative impacts of trade-related LDC graduation in 2030 compared to 2027 (the base year) would result in a decrease in aggregate exports (both goods and services) by 2.4 percent, equivalent to US$ 771.8 million.

The exports of rice will drop by 13.8 percent (US$ 57.3 million), bicycles by 18.2 percent (US$ 243.0 million), and GFT by 8.6 percent (US$ 1.5 billion). As a result, the gross domestic product (GDP) growth rates would reduce by 2.0 percent (equivalent to US$ 750.4 million) and see a 1.8 percent loss in employment (equating to 168,000 jobs, with 57.8% of them being women workers).

5.2. Socio-Economic Impacts Using DCGE Model Simulation Design

Table 2 presents the different scenarios considered to assess the extent of the socio-economic impact and loss recovery due to the LDC shock.

Figure 2. Potential impacts of LDC graduation from baseline 2027-2030



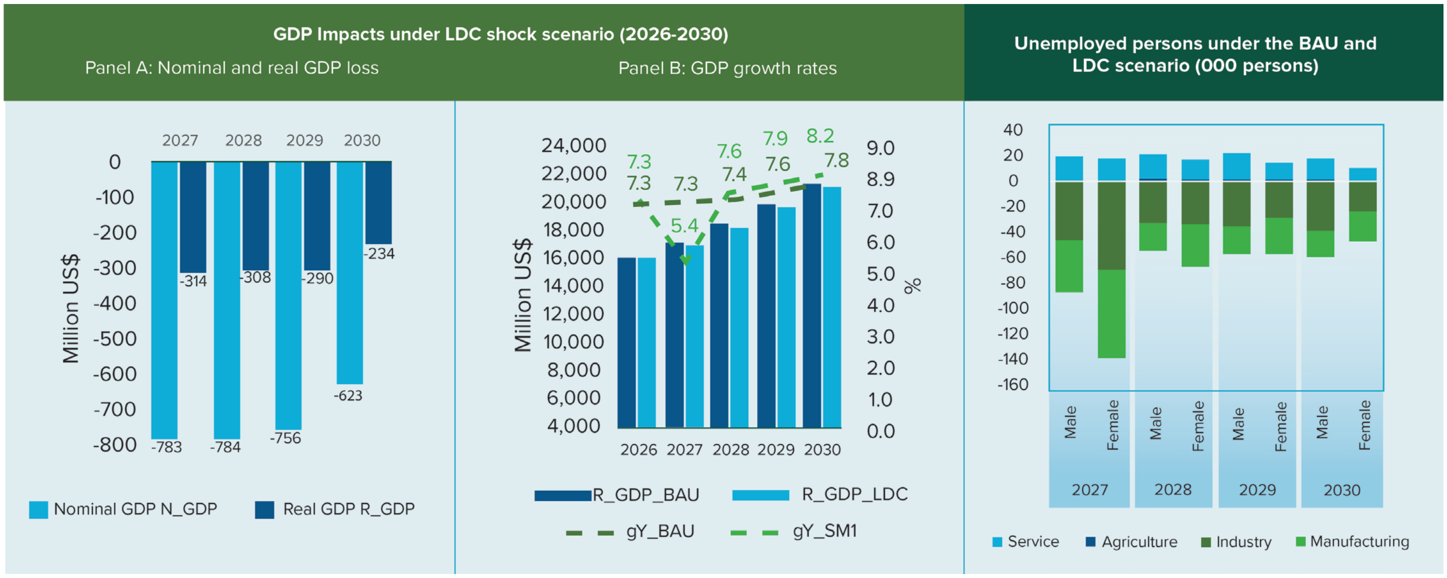
Source: Dynamic GTAP Model and Author's Estimate. BAU was based on IMF's World Economic Outlook (October 2023)

Table 2. LDC simulation design

Simulation	Description	Implementation in the DCGE model
Business as Usual (BAU)	The business-as-usual scenario for 2026-2030 assumes a stable economy with GDP growth rates ranging from 7.3% in 2026 to 7.8% in 2030, aligning with the Ministry of Economy and Finance projections.	Serve as benchmarks for assessing the impact of export demand shocks.
SIM 1 (LDC Shock)	LDC graduation impacts Cambodia mainly through export loss. The simulation focuses on export demand shocks.	In 2027, key exports like rice (-15.6%), textiles (-7.4%), and bikes (-17.3%) will decline, while other products will increase (14.4%)
SIM 2 (trade facilitation)	Public investment equivalent to 2% of all exports products provided over the 2027 to 2030 period. Total intervention amount is US $2.148 billion.	All export industries
SIM 3 (digital economy)	Total intervention amount of US $2.148 billion has been injected as digital economy investment for the 2027-2030 period.	Post and telecommunication sector
SIM 4 (tourism expansion)	Total intervention amount of US $2.148 billion injected as tourism investment over the 2027-2030 period.	Hotels, restaurants and transport services

[6]Economy-wide modelling approach: The study used 2027 as the base year for estimation since Cambodia was originally due to graduate as early as 2027. However, a five-year graduation preparation period has been granted in 2024, instead of three.

Figure 3. GDP and employment impact under LDC shock scenario



Source: Cambodia DCGE model

LDC shock scenario. This scenario is based on the Dynamic Computable General Equilibrium (DCGE), the Cambodian economy contract. Over the 2027 to 2030 period, national income is projected to reduce by US $2.947 billion (US $1.146 billion in real income) compared to the Business-As-Usual (BAU) nominal income. The GDP growth rate will fall to 5.4% in 2027 compared to the BAU growth rate of 7.3%. The textile, agriculture, and bicycles and other cycles activities sectors will be hit the hardest, as measured by percentage point reductions from their base GDP values. In this LDC shock scenario, more than 165,000 persons may become unemployed after LDC graduation, of whom more than 57% will be women workers. The number of new poor persons due to LDC shocks is estimated at 144,000 in 2027, 122,000 in 2028, 95,000 in 2029, and 70,000 in 2030, leading to around 432,000 non-poor persons slipping into poverty due to LDC graduation.

Intervention Scenarios

To compensate for the income and job losses and counter the rise of poverty, three intervention scenarios can be considered. In all the three intervention scenarios, the resources injected are equal to the resources lost, amounting to US $2.148 billion. The impacts on the GDP are positive but variable. In all scenarios, the GDP can shift from negative to positive, but the LDC induced income loss is not fully recovered in any of the three. Similar to income and job loss, poverty improves under the three intervention scenarios but it still falls short in making up for the loss predicted under the LDC graduation scenario. The most substantial GDP gains manifest in SIM 3 (tourism), where the nominal GDP registers a noteworthy increase of US $2.606 billion, closely approximating the total GDP loss of US $2.947 billion incurred in the LDC simulation.

Photo by Ros Santhy

6. Recommendations:

1. Enhancing competitiveness is crucial for Cambodia to counter its progressive loss of trade and investment competitiveness. Policy measures should focus on improving economy-wide productivity, investment on human capital, reducing capital and energy costs, and enhancing transport logistics. Trade facilitation, expediting administrative reforms such as anti-corruption measures, civil service reform and judicial reform, investment in key ports, and robust policy implementation can bolster competitiveness. Cambodia should also reposition itself to attract investment in high-value, technology-intensive industries by prioritizing productivity-enhancing incentives. Measures include nurturing high-skilled labour forces, promoting technology transfer, strengthening of backward and forward linkages and strengthening domestic industries, particularly Micro, Small, Medium Enterprises (MSMEs).

2. Sustainable transition pathway(s): Developing a smooth transition strategy (STS) is critical to define clear criteria for "preparedness" and sustainable transition pathway post LDC graduation with transition measures ensuring continued support from preference granting countries while industries could adapt to new trade dynamics, such as green standard and RoO imposed by the EU and UK. The Government should proactively advocate preference-granting coun3tries like Australia, Canada, China, Japan, India, and South Korea to emulate the EU and the UK's three-year post-graduation transition period for LDCs, enabling continued access to support measures.

3. Export diversification: This includes diversifying goods and services, and exploring new markets such as Japan, BRICS, Latin America, and the Middle East. This would be complemented by efforts to enhance productivity and competitiveness, trade facilitation, and incentives for diversification.

4. Maximizing existing and post-graduation trade preferences. It would be beneficial for Cambodia to engage with the EU and Canada to maintain existing preferences and facilitate smoother transition. This would entail supporting industries in complying with stricter rules of origin and exploring derogations with the EU such as EBA transition period, industry-specific preferences (textile and apparel, and agricultural products), and RoO flexibility. Cambodia should also consider ratifying the EU's GSP+ conventions.

5. Increasing investment in climate resilience and green development of the economy for a resilient growth model and new trade opportunities. Unlocking climate finance, attracting investment in community-led adaptation, high-impact and high-value green supply chains, and linking green commodities to global trade platforms and investors will open new opportunities for strengthening socioeconomic resilience and inclusion for the most vulnerable members of society. Cambodia's major trade and investment partners are transitioning to a net-zero economy, presenting new opportunities for sustainable trade through manufacturing and exporting low-carbon goods and services, renewable energy technology, and deforestation-free products, positioning Cambodia as a regional champion.

6. Proactively assessing the impacts and consulting stakeholders. Sectoral deep dives for identifying impacts and future sources of growth associated with export-sector and consultation with recently graduated countries for policy insights and proactively developing a STS are recommended measures.

7. Comprehensive sector measure: This entails implementing comprehensive interventions across various sectors and strengthening social protection to offset income loss, post-graduation. Cambodia could prioritise the expansion of digital economy and the promotion of high-value tourism with adequate support.

8. Employment aspect: Advocate for lower RoO thresholds with preference-granting countries, especially for MSMEs, supporting larger firms, generators of employment and study the impact on the job market to advocate for greater concessions. Given the impact on the labour market in a country facing challenges in generating decent jobs, the RGC could emphasize this to advocate for concessions.

9. Expanding social protection: The emergence of a new poor post-graduation may create a need to expand social protection coverage. Considering the gender bias of the impacts, the use of digital technologies and gender-responsive designs are recommended for effective targeting.

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