POST-ATC TRENDS IN THE TEXTILE AND CLOTHING SECTOR

- POLICY RESPONSE AND OPTIONS -

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I. Introduction

Over the past decade, the garment sector has been the main engine of economic growth in Cambodia, accounting for 15% of gross domestic product on average. The profile of the sector, however, raises concerns about whether it can continue to contribute to the growth and development of Cambodia's economy.

First, the stimuli of the sector are quotas, which expired in January 2005, and preferential treatments granted by the U.S. and European nations, which helped blanket the competitive disadvantages of the sector. Accustomed to operating in an uneven playing field, the sector will face severe challenges in 2009 when the US and EU removes its restrictive policy against China's apparel exports.

Second, the garment sector is largely fueled by foreign direct investments (roughly 85% of the 300 factories are foreign-owned). Given the slow development of Cambodia's financial system, sustaining capital for investment represents another serious challenge for the garment sector in the future.

Third, the spillover effects of the garment sector on the economy appear to be very limited, regardless of the growth of the sector over the years. Most of the input materials (over 90%) are imported. So far, there has been no investment in backward linkage industries. The situation is the same for forward linkage industries, largely hindered by the little development of higher value addition and skills of labor. Moreover, the sector is centered in Phnom Penh, the capital city, which has resulted in massive migration from rural to urban areas. Roughly 95% of the 250,000 workers absorbed by the sector are migrants from the provinces. Thus, despite growth over the years, the sector continues to have little horizontal integration into the economy and has contributed little to the broadening of the economic base.

The vulnerabilities associated with the characteristics above have not come into full effect yet, as the sector continues to operate under a system of safeguards. While the global quota system (Multi-Fiber Arrangement), which had propped the sector over the years, expired in January 2005; the U.S. and European Union imposed new quotas on China a few months afterwards in response to the extraordinary growth of textiles and clothing exports from China, sheltering Cambodia's garment sector from competition once more. The new safeguard measures shall be effective until 2008, after which, the global textile and clothing industry will have to operate solely on the basis of competition.

It is expected that because of the limited potential of competitively diversifying and/or developing the garment sector in Cambodia, the expiry of the safeguards on China in 2008 will result in massive job retrenchment. While there are many dynamic dialogues taking place in Cambodia between relevant stakeholders on how to increase the competitiveness of the sector in order to protect jobs, there are few (if any) discussions about how to support retrenched workers during the *period of structural change*. There has been little attention on what kinds of social plans and safety nets need to be in place to bridge retrenched workers through this transition.

In view of the high likelihood of job losses after 2008 and with the aim of mitigating the negative social impacts, the Friedrich Ebert Stiftung and SÜDWIND Institute launched a project in Cambodia and Indonesia (which is another textile and clothes exporting country likely to be hit by the removal of safeguards on China) to 1) monitor the impact of the expiry of the Agreement on Textile and Clothes (ATC), and 2) enhance forward-looking industrial and employment policies.

This study is a review of the trends of Cambodia's garment sector since the expiry of the ATC and an analysis of its future sustainability and stability when safeguards on China are removed in 2008. In the last chapter, we provide some proposals on industrial and employment alternatives to the garment sector.

II. Trends and Prospects of Cambodia's Garment Sector

In this section of the study, we review the trends of Cambodia's garment sector since the end of the ATC in 2004. We look at the changes in the sector, workers, government and buyers in the post-quota period to forecast the likely future outcomes.

A. Sector

Profile

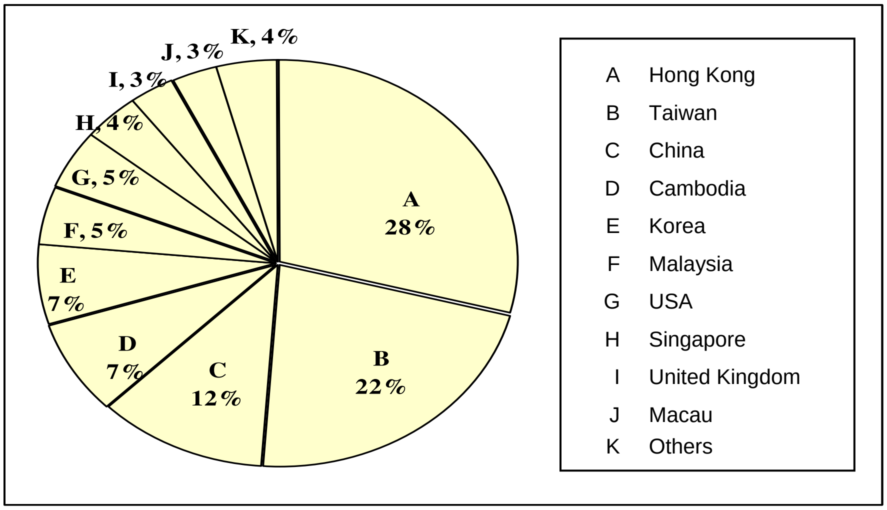
Cambodia's garment sector grew from nothing in 1994 to over $2 billion in 2006, mainly boosted by quotas, bilateral agreements and preferential treatment with the United States and European Union. The sector gradually gained policy attention and played a **dominating role in the economy** – making up more than 15 percent of GDP and 80 percent of total exports.[1] The garment sector absorbs 337,238 laborers, where 92% are young women between the ages of 18-25 years old.[2]

At present, there are approximately 287 factories in operation, clustered primarily in the outskirts of Phnom Penh and Kandal and some in Kampong Cham and Sihanoukville.[3] The sector was built by East Asians, notably Taiwanese, who have supplied the management, pre-production work and the link to customers (for a composition of the

[1] Ministry of Commerce and NIS
[2] Ministry of Commerce and NIS
[3] Ministry of Commerce

origin of factory owners see Figure 1). **Factory ownership and management still remains mostly foreign**.

Figure 1: Composition of Factory Ownership



Source: Garment Manufacturers Association in Cambodia

Factories produce basic, low-end commodity goods, focusing on 'cut, make and trim' work; although some are beginning to diversify into higher value added products such as wool sweaters and men's wool suits. More than half of garment outputs are exported to the United States. The main categories of garment exports are listed in Table 1.

Table 1: Cambodian Garment Exports to US Markets (2004-2006)

CATEGORIES OF EXPORTS	2004	2005	2006
	'000 USD		
Articles Of Apparel Of Textile Fabrics	327,877	445,76	700,162
Women/Girls Coats; Not Knit	509,892	533,272	495,670
Women's Or Girls' Coats; Capes; Knit	220,032	340,950	448,409
Men's Or Boy's Coats; Jackets Etc; Not Knit	220,326	243,531	279,389
Men's Or Boys' Coats; Jackets; Knitted	139,765	137,453	205,894
Apparel & Accessories Except Textile; Headgear	11,439	10,864	4,486
Clothing Accessories	189	1,450	1,874
Total garment exports to US	**1,429,523**	**1,713,286**	**2,135,887**
Percentage of total garment exports	*70%*	*76%*	*81%*

Source: US Trade Department, http://tse.export.gov

Trends and Prospects of the Garment Sector

The quota system that governed the textiles and apparel trade for more than forty years expired at the end of 2004. Many predicted that this would result in severe loss of jobs and exports.[4] However, the US and EU re-imposed new safeguards in 2005 to halter the growth of Chinese garment exports.[5] This means that over the past 2 years, for the most part, Cambodian manufacturers were **still shield from price competition**.

Two years after the end of the ATC, the garment sector is beginning to show some **early signs of slowdown** (key indicators provided in Table 2 below). While the number of factories and employees has increased during this period, growth of garment exports in the post quota regime is decelerating – 17.4 percent in 2006 compared to 24.5 percent in 2004. Gross value added from the sector is also gradually dwindling – from 24.9 percent in 2004 down to 10 percent in 2006.

Table 2: Key Indicators on the Garment Sector (2004-2006)

INDICATORS	UNITS	2004	2005	2006
Number of factories[1]	factories	219	247	290
Number of employees[1]	workers	269,846	283,906	334,063
Garment exports[1]	million USD	2,027	2,253	2,645
Gross value added of Garment[2]	million USD	737	832	916
Share in real GDP[2]	percent	16.34%	17.26%	17.91%
Share of US apparel market[3]	percent	1.98%	2.24%	2.70%
Fixed asset investments in garment sector[4]	million USD	$134	$ 151	63[+]
		Percentage change over previous year		
Number of factories	percent	11.2%	12.8%	17.4%
Number of employees	percent	15.3%	5.2%	17.7%
Garment exports	percent	24.5%	11.1%	17.4%
Gross value added of Garment	percent	24.9%	13.0%	10.0%

Sources: [1] Ministry of Commerce, [2] National Institute of Statistics, [3] US Trade Department, [4] Council for the Development of Cambodia, [+] Up to September 2006

The garment sector is still in a very vulnerable position. There is high risk that most manufacturers **will not be able to absorb the price competition** from China once the safeguards are lifted in 2009. Compared to rivals in other countries, Cambodian factories face higher costs of production, transportation, and administration.

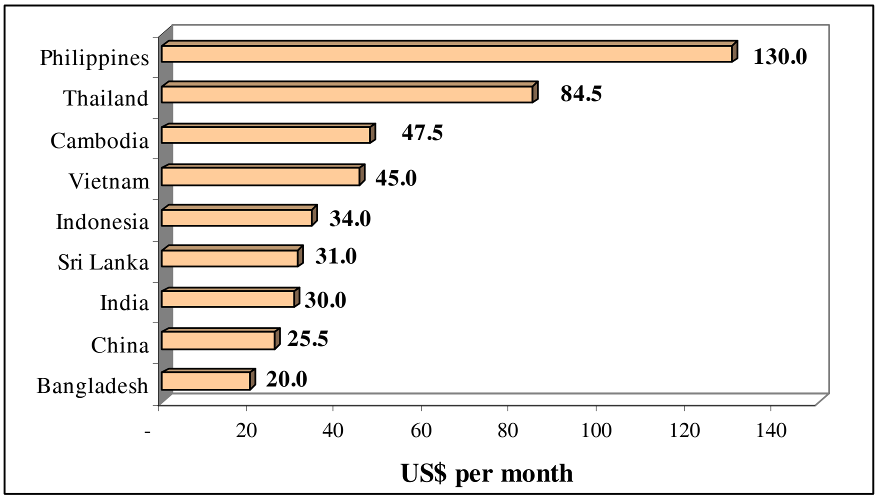
Production Costs

[4] For instance, see *Cambodia's Garment Industry: Meeting the Challenges of the Post-Quota Environment* (ADB, 2004).

[5] The EU installed safeguards on China in June 2005, which was followed by the US in November 2005. The EU safeguards will phase out at the end of 2007, while those of the US will be lifted at the end of 2008.

Cambodia is disadvantaged in terms of labor costs. A look at the minimum wage in selected garment exporting countries shows that the minimum wage in Cambodia is higher than many of its competitors (illustrated in Figure 2). The current minimum wage for the garment sector in Cambodia is $47.50 per month, which is higher than in Vietnam ($45), Indonesia ($34), Sri Lanka ($31), India ($30), China ($25.50) and Bangladesh ($20).

Figure 2: Minimum Wage in Selected Garment Exporting Countries (US$ per month)



Source: CIDS (2005), US Department of Labor, ILO

The comparatively higher wages in Cambodia is not accompanied by higher labor productivity. Value-added per worker[6] is one useful indicator of labor productivity. Despite the relatively higher wages, productivity level in Cambodia is far behind countries with lower wages. As illustrated in Figure 3, value-added per worker in Cambodian factories was $2,862 in 2005, which is almost three times lower than in Vietnam ($7,758) and two

Box 1: Labor Productivity in Cambodia's Garment Industry

A recent study on labor productivity in Cambodia garment industry finds that only 7 percent of the Cambodian factories surveyed operate at what could be considered world-class enterprises, while more than three-fourths have significant potential for upgrading and the rest lag behind enough that they will find it difficult to compete in a free trade environment

Observations from the study:

- Training is weak; poor methods are therefore retained or transmitted rather than reviewed and remedied.
- Management information systems are deficient; inappropriate, inaccurate, or late data raise overhead costs.
- Machines are typically operated inefficiently, and equipment maintenance is often inadequate. Lack of investment in maintenance, plus ineffective spare parts stock control, often leads to considerable lost production.
- Many factories do not employ work-study (time measurement) methods and thus have no formal standards against which to evaluate operators; this lack of standards impedes quality control and efforts to ensure product consistency.
- Staffing levels are generally too high relative to international best practice. This results from poor recruitment and supervisory practices as well as inadequate training.

Source: Nathan Associates (2005). *Measuring Competitiveness and Labor Productivity in Cambodia's Garment Industry.*

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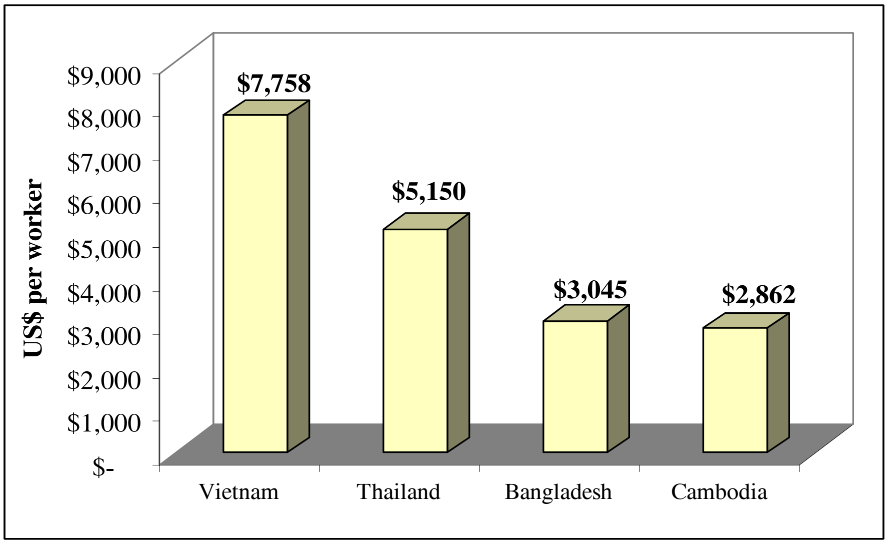
[6] In this study, value added per worker
apparel section at constant prices / nu

times less than in Thailand ($5,150).

Figure 3: Value Added Per Worker in Selected Garment Exporting Countries (in 2005, annual)

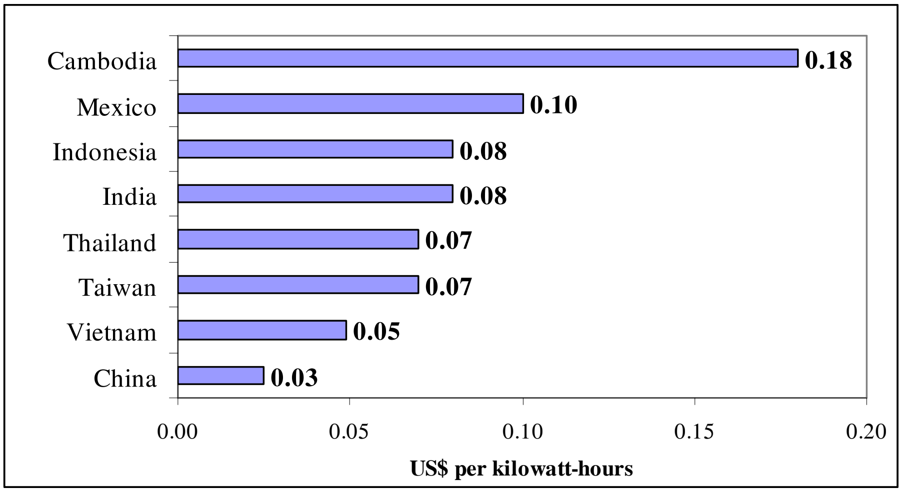


Source: Calculated by CIDS based on data from UN Statistics (http://unstats.un.org) and SRI Lanka Garment Buying Offices Association (2005)

Compared to other garment exporting countries, Cambodia also has the **highest cost of electricity**. Cambodian manufacturers pay 18 cents for one kilowatt-hours of power[7], which is six times higher than what manufactures in China pay (3 cents per kilowatts-hour) and twice as much as that paid by manufacturers in Vietnam, Taiwan, Thailand, India, and Indonesia (shown in Figure 4). In fact, electricity price in Cambodia is one of the highest in the world (note that electricity in the US is 10 cents per kilowatts-hour).

Figure 4: Electricity Prices in Selected Garment Exporting Countries (US$ per kilowatts-hour)

[7] The rate of 18 cents per kwh applies only in Phnom Penh. In the provinces, the rate is much higher. For instance, the price of electricity in Kampong Cham is 24 cents.



Source: Energy Information Administration, Newspaper clippings

Administrative Costs

The need to import raw materials exposes Cambodian manufacturers to **additional administrative costs** related to processing documents. As shown in Table 3, the cost to process import documents in Cambodia is higher than many of its rivals - $816 per container in Cambodia compared to $789 in Sri Lanka, $675 in Indonesia and $375 in China.

Table 3: Processing Import Documents in Selected Garment Exporting Countries

Country	Cost to Import ($ per container)
Philippines	1,336
Bangladesh	1,287
India	1,244
Thailand	1,042
Vietnam	887
Cambodia	**816**
Sri Lanka	789
Indonesia	675
Malaysia	428
China	375

Source: World Bank, 2007

Producers must pay a hefty cost for processing export documents. Cambodian manufacturers must pay approximately $736 per container to obtain export documents, much higher than in Vietnam ($701), Indonesia ($546), Malaysia ($481) and China ($335). These high administrative costs reduce the flexibility of Cambodian manufacturers to compete with rivals.

Table 4: Processing Export Documents in Selected Garment Exporting Countries

Country	Cost to Export ($ per container)
Philippines	1,336
Bangladesh	902
India	864
Thailand	848
Sri Lanka	797
Cambodia	**736**
Vietnam	701
Indonesia	546
Malaysia	481
China	335

Source: World Bank, 2007

Transportation Costs

Transport costs can be represented by the difference between the CIF product values and CIV values.[8] CIF means the value of product 'cost, insurance and freight', which is reported by the importing country. CIV or 'customs import value' is the price actually paid for the merchandise, excluding import duties, freight, insurance, and other charges incurred in the importing of merchandise. The CIV values can be obtained from the United States' trade recording system. The difference between the CIF value and the CIV value represent the aggregate cost of all freight, insurance, and other charges incurred in transporting merchandise from alongside the carrier at the port of exportation to alongside the carrier at the first port of entry.

Table 5 lists the transport cost margins for selected garment exporting countries. **Cambodian manufacturers face higher transport costs** than those in Sri Lanka, Thailand and Mexico, but slightly lower than Indonesia, India and Vietnam.

Table 5: Transport Costs for Selected Garment Exporting Countries

Country	CIF / CIV Margin
Bangladesh	7.11%
Vietnam	6.90%
India	6.81%
Indonesia	6.38%
Cambodia	**6.33%**
Taiwan	6.09%
Sri Lanka	5.82%
Thailand	5.78%
China	n/a
Malaysia	n/a

Source: Bargawi, 2005

[8] For more details see Bargawi, 2005.

Lead time[9] in Cambodia is longer than in other garment exporting countries. While the relative distance between Cambodia and export markets (US) is a natural disadvantage in itself, this drawback is intensified by delays in processing export and import documents (for a list of lead times see Table 6). Cambodian manufacturers spend 36 days on average to clear exports and 45 days for imports; whereas Chinese producers spend only 18 days for export and 22 days for imports. It takes approximately 103 days to ship final garment products from the ports of Cambodia to the US, almost double the time it takes Chinese manufacturers.

Table 6: Lead Times for Selected Garment Exporting Countries

Country	Days for Export (1)	Days for Import (2)	Shipping Days to US (3)	Lead Time (1+2+3)
Bangladesh	35	57	27.1	119.10
Cambodia	**36**	**45**	**22.6**	**103.60**
India	27	41	25.0	93.00
Indonesia	25	30	22.5	77.50
Pakistan	24	19	26.0	69.00
China	18	22	15.0	55.00
Taiwan	14	14	14.3	42.30
Hong Kong	6	5	14.9	25.90

Source: World Bank, 2007 and Veson Nautical, http://apps.veson.com/distances

The assessment above suggests that most manufacturers in Cambodia will not be able to absorb price competition when safeguards on China are lifted in 2008, especially because many of the **high cost items faced by producers are outside their factory**, such as the costs of electricity, administrative and transportation. Indeed, the decelerating growth rate of the sector (as shown in Table 2) is an early sign of contraction. It is highly likely that the **sector will gradually decline when trade restrictions on China are finally removed; the residual is massive retrenchment of workers**.

B. Workers

Profile

More than 300,000 workers are directly employed in the garment sector. Ninety-two percent are women, and between the ages of 18 – 25 years old. They come from rural areas, mostly from Prey Veng, Kampong Cham, Kandal and Takeo provinces. They migrate outside their hometown to find work because of the severe lack of livelihood options in their village. A large portion of their earnings is sent home to support their families (approximately $11 million dollars per

Box 2: Labor Unions in Cambodia's Garment Industry

The interests of garment workers are represented by a large number of labor union organizations under the umbrella of federations. At present, there are 25 federations and around 325 formal unions for garment workers. On average, there are 2-3 unions per factory. Union activities are mostly prominent in Phnom Penh and Kandal province. Anecdotal evidence suggests that intensifying competition for members is spurring tension between unions.

Source: CIDS based on interviews with trade unions and federations, May 2007

[9] Lead time is the time between the receipt of an order and delivery to buyers.

month flows to the provinces in the form of remittances from garment worker). Most workers carry only a primary education and are only semi-literate. Their vocational training generally consists of a few hours of sewing lessons from an informal training facility, costing around 2,000 riels per hour.[10] In general, workers are members of a labor union (see Box 2 for more information on union activities in Cambodia).

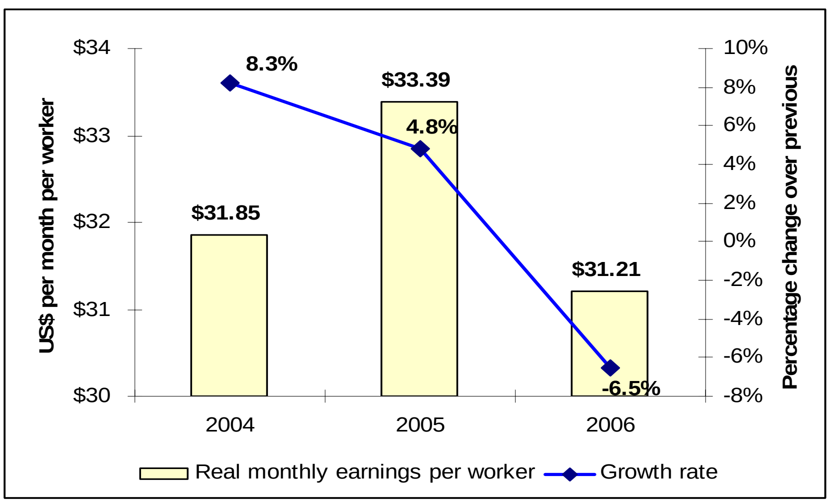
Trends in Working Conditions

In our review of working conditions, we look at changes in real wages, health and factory compliance to requirements on wages, contracts, and overtime pay.

Wages

The minimum wage for garment workers is presently $47.50[11]. With overtime and other benefits, most workers earn about $70-80 per month. Taking account of inflation, the real wages received by workers is approximately $31.21 in 2006. **Real wages are rapidly decelerating–** compared to 2005, real wages dropped by 6.5 percent in 2006 (illustrated in Figure 5 below).

Figure 5: Real Wages of Garment Workers in Cambodia at constant 2000 prices (2004-2006)



Source: CIDS based on data from NIS and MOC

Health & Nutrition[12]

According to a recent worker survey by the ILO and World Bank (2006), the most common reason for taking sick leave by workers was fever (25.9% of 975 workers), followed by feeling faint/dizzy/unconscious (23.9%), and diarrhea (13.9%). Managers

[10] See Nathan Associates (2006) for a comprehensive assessment on the skills and training needs of garment workers in Cambodia.
[11] This rate is the most current minimum wage agreed between unions and employers association (Garment Manufacturers Association in Cambodia or GMAC) in late 2006 via collective bargaining.
[12] This section is paraphrased from ILO & World Bank, 2006

mentioned typhoid as the most common cause of sick leave requests, followed by diarrhea, feeling faint/dizzy/unconscious and fever.

Malaria and dengue were the two most common fever caught by workers and managers. The majority of women (90.8%) reported that they always sleep under a mosquito net. Seven out of ten managers surveyed mentioned that **there are mosquitoes in the factory**.

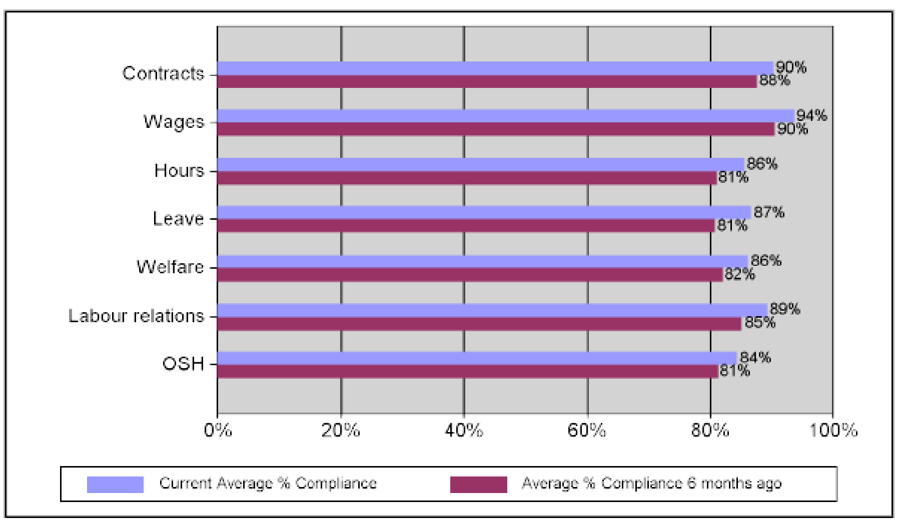
Workers who said they never had enough to eat as well as those exposed to chemicals and cloth debris were more likely to have taken time off work for feeling faint/dizzy/unconscious.

More than half of the workers surveyed said they do not wash their hands with soap every time they use the factory's toilet. Workers in smaller factories (500-999 workers) had a significantly higher figure than those in larger factories (more than 3,000 workers). Some reasons raised by workers on why they do not wash their hands with soap are: no soap available, not enough time, and factory does not have a hand-washing facility.

Factory Compliance

Better Factories Cambodia, a program managed by the ILO, is the leading institution for monitoring and reporting on factory compliancy to the Labor Law. According to the most recent ILO monitoring report dated April 2007, the current trends of working conditions appear to be positive (graphics shown in Figure 6)[13]:

Figure 6: Compliance to Selected Requirements (% of 223 factories complying)



Source: Better Factories Cambodia, April 2007; OSH means occupational safety and health

[13] These findings are based on inspections of 223 factories.

Box 3: Legal Requirements on Dismissing Employees

SUSPENSION
A factory may suspend an employment contract for serious economic problems but under the supervision of the Ministry of Labor. The maximum length of suspension is 2 months. During this period, the employer is not required to pay wages and the employee is not required to work.

TERMINATION OF UNDETERMINED DURATION CONTRACT
- Due to serious misconduct – no lay off compensation
- Due to economic reasons – lay off compensation
- Due to other misconduct – lay off compensation

Lay off compensation is based on length of employment. If worked for 6 months to 1 year, entitled to 7 days wages and benefits. If worked for over 1 year, entitled to 15 days for each year of employment.

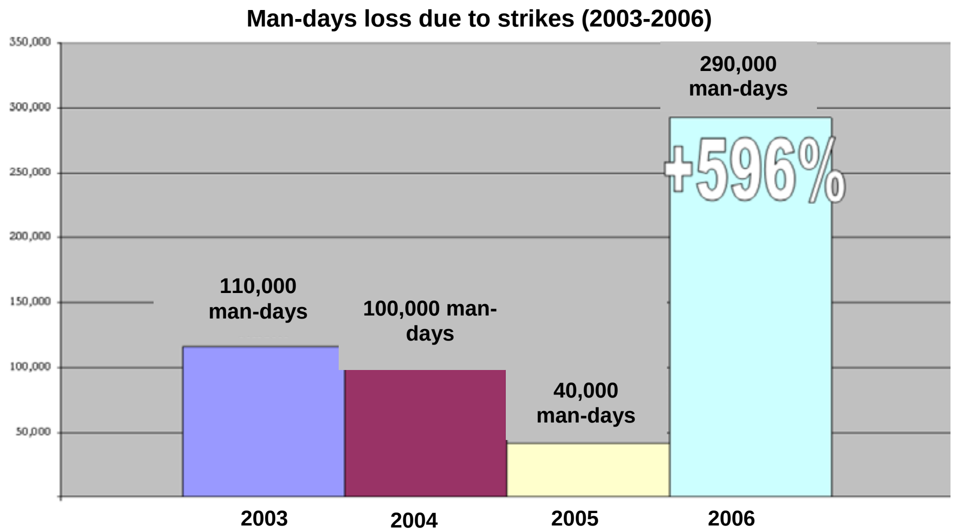
TERMINATION OF FIXED DURATION CONTRACT
If terminate before end of term:
- By agreement – 5% severance of total wages earned to date of termination
- Other reasons – wages for full contract + 5% severance of total wages earned
- Serious misconduct – 5% severance of total wages earned to date of termination

Source: Cambodian Labor Law

The report states that there have been overall improvements in compliancy of legal requirements on contracts, wages, hours, leave, welfare, and occupational safety and health (OSH) over the past 6 months Most factories monitored follow the legal requirement when it comes to minimum wage for regular workers and piece-rate workers, but not so much for casual workers. Overtime is also correctly applied by most factories for all types of workers. Although the report shows a high compliance rate for labor relations, the number of man-days loss due to strikes increased dramatically in 2006 (see Box 4). The area of least improvement is payment of severance pay upon expiration or termination of fixed term contracts (refer to Box 3 for details on legal requirements for dismissing employees).[14]

Box 4: Unions, Factories and Strikes

Tension between unions and factories has been sharpening. The man-days loss due to strikes increased by 596 percent in 2006 compared to the previous year.



Source: Garment Manufacturers Association in Cambodia (GMAC)

[14] ILO, 2007

Situation of Retrenched Workers

Since the expiry of the ATC in December 2004, more than 10,000 jobs have been loss and 4,000 plus jobs have been temporarily suspended (see Table 7). The cumulative number of jobs loss as of April 2007 is 29,918 jobs.

Table 7: Employment in Cambodia's Garment Industry (2003 – 2007)

EMPLOYMENT	Dec-03	Dec-04	Dec-05	Dec-06	Apr-07
	cumulative				
Operational	223,969.00	269,846.00	283,906.00	334,063.00	338,302.00
Temporarily suspended	3,765.00	11,175.00	15,312.00	15,312.00	15,312.00
Definitely closed	16,621.00	19,022.00	29,248.00	29,918.00	29,918.00
	changes				
Operational		45,877.00	14,060.00	50,157.00	4,239.00
Temporarily suspended		7,410.00	4,137.00	-	-
Definitely closed		2,401.00	10,226.00	670.00	-

Source: Ministry of Commerce

Given the difficulty of tracking retrenched workers, we interviewed with labor unions and current garment workers to get a picture of the situation of retrenched workers. According to union representatives, dismissed workers generally receive compensation in compliance with legal requirements and factory policies. There are some incidences of grievances due to loss of owed wages, as reported by local newspaper (see Table 8 for a list of reported cases in newspapers).

Table 8: Grievances due to loss of owed wages – Sample of Newspapers

Loss of Owed Wages
Hang Fung Shing factory - more than 400 workers protested in front of this Phnom Penh factory (Meanchey District, Chak Angre Leu Commune) on Monday demanding salaries that workers said the factory manager fled the country to avoid paying. Union at the facotry is Free Trade Union. Factory suspended operations in Nov and promised to offer regular workers 50% of their Dec salary on Jan 10, but on Dec 20, the factory GM already fled the country *(Cambodia Daily, Jan 11, 2005)* Hang Fung Shing factory - 300 workers protested in front of the PP Municipal Court on Monday seeking quick resolution a lawsuit filed against the manager for fleeing the country without paying salaries. The complaint tasks the court to sell the factory's property to compensate 499 employees who are due wages for Dec. According to FTU rep, te factory promised to pay 50% of employees'$45 monthly salary if they worked one day per week in Dec. MOL rep stated that the factory closed down because it had no buyers from abroad. *(Cambodia Daily, Jan 18, 2005)*
You Cheng factory in Ang Snoul District, Kandal - manager was also accused of attempting to flee Cambodia without paying workers, negotiations hit deadlocked after the factory's Chinese owner did not compensate workers on Monday as announced. Chinese factory owner informed that he would travel to Cambodia on Monday to compensate workers but did not appear. Factory rep stated that they were not closing down only suspending operations, and agreed to pay workers $5 per month each during suspension, but workers asked for $20 per month. *(Cambodia Daily, Jan 11, 2005)*

Sam Han factory - 400 former workers at this factory appealed to SRP lawmakers after police broke up their attempt to demonstrate in front of National Assembly. They plead for compensation. *(Cambodia Daily, Mar 4, 2005)*
Long Heang factory in Ang Snuol District - protested after the factory Chinese owner fled and closed the factory's door without paying salaries, represented by Cambodian Union Federation. 330 workers have not been paid for Feb and Mar. *(Cambodia Daily, Mar 16, 2005)*
Sam Han factory - 400 former workers at this factory appealed to SRP lawmakers after police broke up their attempt to demonstrate in front of National Assembly. They plead for compensation. *(Cambodia Daily, Mar 4, 2005)*

Interviewees informed that the first instinct of retrenched workers is to seek the same kind of employment in another garment factory because they **lack skills to apply for other types of jobs**. In the event that they are unable to secure a job in another garment factory, most workers return to their villages to help their family with **farming activities**. Some workers seek **apprenticeships** in other occupations with the objective of someday **starting their own small business**, such as in hairdressing, beauty care/cosmetics and tailor shops, skills that are easily marketable.

In addition, current garment workers were also asked about their future objectives. Almost all of the women interviewed have plans to **return to their village** if they are dismissed from the factory. Most have plans to make a living in their village by starting a small business such as beauty care/cosmetics, hairdressing, grocery and retailing clothes. They intend to get some skills training in Phnom Penh before returning home. The women interviewed informed that they have some savings to finance their plans, but most mentioned that it is still insufficient.[15]

Some challenges that retrenched workers are likely to face include:

- rice harvest insufficient and/or farming income is not sufficient to compensate for loss income from being a garment worker
- lack of capital to start up business
- wage work opportunities around village limited
- little skills and education

These obstacles are the factors that initially pushed women to find work outside their village.[16]

[15] These findings on the future objectives of garment workers are similar to the findings of a survey carried out by EIC and UNDP in 2006. See: EIC (2007). *Cambodia Garment Industry Post ATC – Human Development Impact Assessment.* Phnom Penh, Cambodia.

[16] For a survey and case studies on reasons behind migration in Cambodia, see CCC (2005). *Impact of the Garment Industry on Rural Livelihoods: Lessons from Prey Veng Garment Workers and Rural Households.* Phnom Penh, Cambodia.

C. Government

In response to the quota expiry, the Royal Government of Cambodia (RGC) has undertaken measures to **improve the business environment** for existing investors as well as to attract new investors.

One of the key strategies of the RGC to enable a more conducive environment as well as to broaden the economic base is to establish **export processing zones and special economic zones** in provincial areas. These zones will include government support in building road networks, developing power and water supply, ensuring waste management and environmental protection, as well as provisions in education and vocational training, health services, and reduced customs procedures. The *Export Growth Corridor* is the most well-known zone currently being developed (with support from Japan) and covers Phnom Penh, Sihanoukville, Kandal, Takeo, Kampong Speu, Kampot and Koh Kong. There are also zones in Poipet and Svay Rieng.

Measures have also been taken to **improve trade facilitation** by simplifying and reducing the costs of customs procedures. Some plans of the RGC include installing a single-window process in Sihanoukville Port, develop a single administrative document, automate customs process and review the roles and responsibilities of different agencies.

Most recently (and directly related to garment manufacturers), the National Assembly passed an amendment in the Labor Law to reduce the nightshift rate from 200% of day rate to 130%. According to the government, this move could create 250,000 new jobs in the garment sector and is more in line with other countries in the region.

D. Buyers

The top buyers of Cambodian garments are Gap, Adidas, H&M, Levi Strauss, Sears, Wal-Mart, Nike, Reebok and other major retailers. Together, these buyers purchase about $1 billion of the nation's $2 billion garment exports. Gap is the largest buyer of Cambodia, representing about a third of total garment exports.

Twice a year *Better Factories Cambodia* convenes an International Buyers Forum. The conference is attended by representatives of the top 16 largest buyers of Cambodian garments, government officials, manufacturers and unions. The objective of the Forum is to discuss and develop common strategies to **improve working conditions** and strengthen the garment sector. At these Forums, buyers share their perspectives and sourcing considerations (see Box 5 for a list of top sourcing considerations).

Over the past two years, the dialogue has evolved as following:

Dec 2005 Forum

- Buyers praised increasing labor standards in Cambodia, but said that threats to human rights and political freedoms may make them rethink their commitment to Cambodia
- Discussed forming a council to increase their monitoring of labor standards
- Some buyers, like Sears, which is the number five buyer, stated that its decision to leave Cambodia will be due to internal decisions about its ability to maintain quality control of offices, rather than because of the business environment here.

Dec 2006 Forum

- Buyers expressed their high regards for BFC and integrity of reports
- Stated that their sourcing decisions is related to the reputation of good labor standards in Cambodia, but equally important factors that will determine their sourcing plans include on-time delivery, price and quality

The next Forum is planned for July 2007.

Box 5: Priority Sourcing Considerations of International Buyers

Total Cost
- Business climate and infrastructure
- Political stability and security
- Transparent regulation, low corruption
- Compliance with ILO standards
- Vulnerability to trade remedy actions
- Incentives: subsidies, tax credits, FTZs
- Real exchange rates
- Market demand and economic growth

Level of Service/Reliability of Supplier
- Reputation for quality and speed
- Existing business networks
- Level of service provided
- Flexibility and variety of products

Labor and Management
- Availability of workers and wage rates
- Labor skills and productivity
- Availability of qualified managers

Raw Material Availability
- Competitive local supplies
- Low tariffs on imports of raw materials
- Favorable rules of origin for trade preferences
- Availability of capital

Speed to Market
- Proximity to import markets
- Quick turnaround times

Source: AccountAbility (2005).

III. Looking Forward - Industrial Alternatives

The review of the garment sector in the previous chapter predicts that Cambodian manufactures will face difficulties in absorbing price competition in a free trade environment. While the reputation for good labor standards in Cambodia is a competitive advantage, it is not sufficient to attract buyers. The removal of safeguards on China at the end of 2008 will alter the environment for apparel trade, and buyers will nevertheless need to consider sourcing strategies that maintain (or increases) their competitive positions. Price and timeliness, two criteria in which Cambodia is at a disadvantage, will be priorities for buyers when considering their sourcing plans. In the meantime, government reforms to improve the business environment are apparently not fast enough to overturn the situation by 2008. Thus, it is highly likely that most **Cambodian garment factories will not be able to survive in the new, free trade environment**. **The residual is massive retrenchment of garment workers.** To avoid deterioration in human development, there is a need to create safety nets and employment as well as industrial alternatives.

In this chapter, we consider possible industrial and employment alternatives that could potentially replace the garment sector. The first section describes the frame of analysis for identifying possible sub-sectors, and the second section presents the findings.

A. Frame of Analysis

A deductive approach is used to identify and select high potential sub-sectors in the economy that could possibly serve as an industrial and employment alternative to the garment sector (Box 6 summarizes the frame of analysis).

The first step of our analysis is to identify sub-sectors. We look at four key indicators and its trends in the selection process: growth rates, share in GDP, level of employment, and investment.

The second step consists of a rapid assessment of the identified sub-sector. We rank the selected sub-sectors in terms of its growth potential (i.e. market demands, factor conditions, value-added potential...) and fulfillment of development objectives (employment creation, integration of retrenched garment workers, gender aspects...).

Box 6: Frame of Analysis

Step 1 - Identify Potential Sub-Sectors
Criteria:
- Growth
- Significance in GDP
- Employment absorption
- Investment

Information Source:
- Secondary national statistics

Step 2 – Rapid Assessment of the Sub-Sectors
Criteria:
- Growth Potential
  - future market trends
  - factor conditions
  - local value added potential
  - domestic industry structure
- Development Objectives
  - employment creation
  - integration of retrenched garment workers
  - gender aspects

Information Source:
- Consultations
- Findings from various surveys
- Secondary national statistics

B. Potential Sub-Sectors Identified

In our investigation of industrial and employment alternatives to the garment sector, we conducted a macroeconomic scan to identify the sub-sectors with the highest potential to contribute to sustainable growth, employment absorption and industrial development. In this regards, we look only at the industry and service sectors. Our analysis is based on the trends of four key indicators: share in real GDP, growth rates, level of employment, and investment. Table 9 displays these indicators by sub-sectors.

The data reveals that:

- There is **no single sub-sector with the capacity to absorb high volumes of employment and significantly contribute to GDP**, so as to compensate for potential losses in the garment sector. On a three year average from 2004 to 2006, the garment sector absorbed 13.5 percent of total employment in the industry and service sector, and made up 15.2 percent of GDP.
- Besides the garment sector, the following sub-sectors take in the **highest portions of the labor force** in the industry and service sectors (figures below are in three-year averages):
    - trade – 34.4 percent
    - construction – 7.4 percent
    - transport and communications – 6.3 percent
    - food, beverages and tobacco – 6.2 percent
- Besides the garment sector, the following sub-sectors make up the **largest shares in GDP** (figures below are in three-year averages):
    - trade – 8.5 percent
    - transport and communication – 6.1 percent
    - hotel and restaurants – 4.2 percent
- Trade includes motor vehicle sales and repair, wholesale businesses, and retail businesses. While the trade sub-sector reveals to have the highest absorption of labor and growth rate compared to the other sub-sectors, it cannot serve as an alternative to the garment sector because it is a residual sub-sector that depends on growth in other sub-sectors, especially the garment sector.

The implications of these findings are:

- To overcome this situation, a **cross-sectoral strategy** that utilizes and strengthens the **existing linkages within the economy** may produce the desired outcome of high employment generation and high impact on GDP. The strategy should consider combining small but emerging, high growth sub-sectors in order to create synergies with the economy.
- The benefits of a cross-sectoral strategy are:
    - strengthening and broadening of the economic foundation
    - increase in value added retention within the economy

- possible spillover effects into other branches of the economy

The recommended sub-sectors are 1) food, beverages and tobacco, and 2) hotel and restaurants. Together, it makes up more than 7 percent of GDP and absorbs at least 241,400 workers, mostly women[17]. The benefit of this combination is the **existing linkage between domestic input markets and domestic output markets.** Raw materials are locally available for processing, and demand in local markets (that is, hotel and restaurants) for these products already exists. Moreover, food-processing requires moderately **low levels of investment**, which makes market entry for domestic investors possible. Furthermore, growth in either of these sub-sectors could **induce investment in other branches** such as 'construction' and 'transport and communication', creating a growth dynamic for further growth and development. These benefits are necessary conditions for sustainable growth and development, and could help broaden the economic base.

[17] National statistics account only for registered businesses; thus, the number of laborers is likely higher if we take account of the vast number of unregistered businesses.

Table 9: Key Economic Indicators of Selected Sub-Sectors

SUB-SECTORS	Share of REAL GDP (%)			Growth Rate (%)			Employment ('000 workers)			Investment (million US$)		
	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006*
Industry	**27.3**	**27.0**	**27.8**	**16.4**	**12.1**	**9.1**	**947.0**	**1,059.0**	**1,164.9**	**176.0**	**931.0**	**235.5**
Food, Beverages, & Tobacco	2.5	2.4	2.3	(1.0)	8.0	4.0	180.0	197.3	218.3	6.0	27.0	**194.6**
Textile, Apparel, & Footwear	**15.3**	**14.9**	**15.5**	**24.9**	**10.3**	**10.0**	**396.0+**	**434.0+**	**480.2+**	**136.0**	**202.0**	**n/a**
Wood, Paper & Publishing	0.4	0.4	0.5	4.4	6.6	2.0	57.6	63.1	69.8	4.0	3.0	n/a
Rubber Manufacturing	0.3	0.2	0.2	(11.5)	(8.9)	0.0	7.2	7.9	8.7			n/a
Other Manufacturing	2.0	1.9	1.9	3.2	11.0	5.0	79.2	86.8	96.0			n/a
Plastics	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	1.0	10.0	n/a
Cement	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	0.0	181.0	n/a
Construction	6.0	6.3	6.6	13.2	20.1	11.0	195.0	234.0	291.2	0.0	30.0	n/a
Services	**36.7**	**36.2**	**36.2**	**11.7**	**12.1**	**6.0**	**2,027.0**	**2,163.0**	**2,314.4**	**153.0**	**211.0**	**2,092.7**
Trade	8.8	8.4	8.3	5.5	8.4	5.0	1,043.0	1,104.0	1,180.3	n/a	n/a	n/a
Hotel & Restaurants	4.1	4.2	4.4	23.4	17.3	10.0	20.3	21.6	23.1	38.0	107.0	15.0
Transport & Communication	6.1	6.1	6.1	7.5	13.1	6.0	195.0	206.0	208.3	-	13.0	n/a
Finance	1.1	1.2	1.2	20.7	19.3	6.0	n/a	n/a	n/a	n/a	n/a	n/a
Sources	A	A		A	A	B	C	D+C	C	D	D	E

Sources:

A NIS National Accounts 2003-2005

B National Strategic Development Plan 2006-2010 (RGC) - estimated and projected figures are based on National Account figures in 2004

C Extrapolated by CIDS based on data from NIS Statistical Yearbook 2005 and MIME Industrial Survey 2004; assuming constant growth in employment

D NIS, IMF and CDC as extracted from Annual Development Review 2006-07 (CDRI)

E CDC

* Up to May 2006

\+ Employment for 'textile, apparel and footwear' includes those in registered (based on national statistics) and unregistered enterprises (estimated)

C. Assessment of the Growth Potential of the Food Processing Sub-Sector

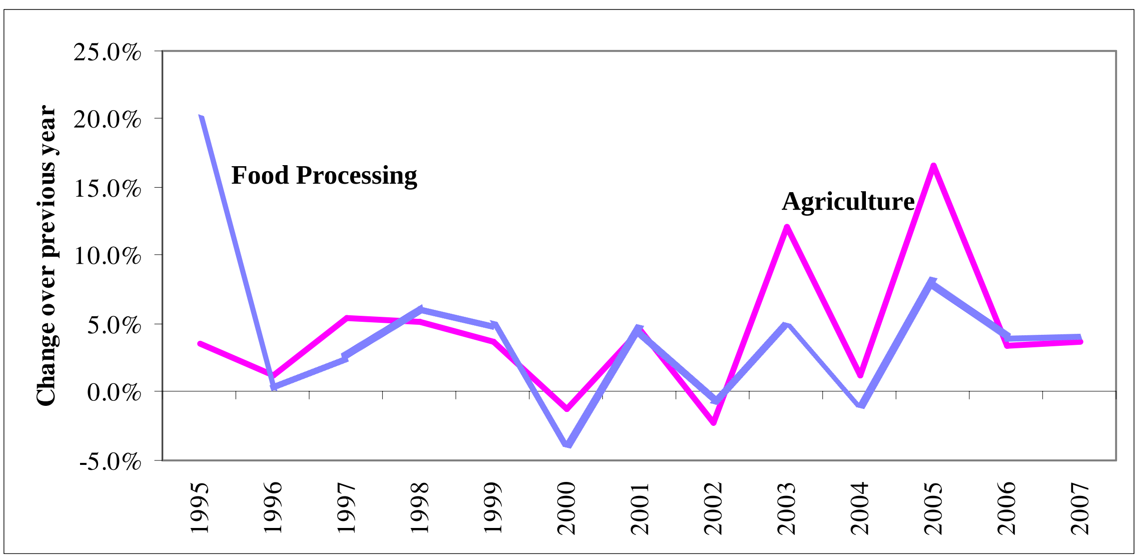
In this section of the report, we analyze the growth potential of the 'food, beverages and tobacco' sub-sector (henceforth referred to as food processing sub-sector) by exploring its future market trends, factor conditions, local value-added potential, domestic industry structure and responsiveness to changes in demand. Additionally, we also consider other development criteria such as employment creation, integration of retrenched garment workers, and gender aspects.

Growth Potential

Future market trends

Growth in the food processing sub-sector is strong. Though it shrunk in 2004 by -1.1 percent, the sub-sector quickly bounced back in the subsequent year to 8 percent growth and is estimated to grow by 4 percent in 2006. The up and down swings in the food processing sub-sector follows the same trend as the agriculture sector (illustrated in Figure 7).

Figure 7: Growth Trends in Food Processing and Agriculture Sector (1995-2007)



Source: NIS National Accounts 2004-2005 and National Strategic Development Plan 2006-2010

The size of the domestic market is promising. Cambodians spend approximately 2/3 of their income on food, beverages and tobacco.[18] Based on this information, the market size of the food processing industry reached $4 billion in 2006 and is projected to increase in 2007 and 2008 to $4.3 billion and $4.7 billion, respectively (shown in Table 10).

Table 10: Market Size of Food, Beverages, and Tobacco Sub-Sector

Estimates	2006/e	2007/p	2008/p
	million USD		
Real GDP at 2000 prices	6,020	6,592	7,185
Expenditure on Food, Beverages and Tobacco	4,013	4,395	4,790

Source: Estimates and projected figures based on data from NIS National Accounts 2004-2005 and ADB Outlook 2007

Factor conditions

Main inputs for processing food can be locally supplied. The top agricultural products include cassava, maize, soybean, vegetables, sugar cane and livestock (Table 11 below provides a list of main products and clusters). On an anecdotal basis, it is recognized that the bulk of agricultural products is exported and/or sold inside the country unprocessed.

Table 11: Main Agricultural Products and Clusters

Agriculture Product	Production	Cluster
Cassava	535,623 ton	Kampong Cham, Battambang, Siem Reap
Maize	247,760 ton	Battambang, Pailin Town, Kampong Cham, Kandal
Soybean	179,096 ton	Battambang, Kampong Cham, Pailin Town
Vegetable	172,399 ton	Kampong Cham, Kandal, Kampong Chhnang, Siem Reap
Sugar Cane	118,164 ton	Mondulkiri, Kratie, Battamabang, Kandal, widespread in other provinces as well
Sesame	56,711 ton	Pailin Town, Kampong Cham, Preah Vihear
Mung Bean	45,041 ton	Battambang, Kampong Cham, Kandal
Sweet Potato	39,142 ton	Kampong Cham, Kampot, Battambang
Peanut	22,629 ton	Kampong Cham, Battambang, Kandal
Tobacco	14,413 ton	Kampong Cham
Jute	826 ton	Battambang
Cattle	3,187146 head	Kampong Cham, Kampong Speu, Takeo
Buffaloes	676,646 head	Svay Rieng, Prey Veng, Kampong Cham
Poultry	15,085,547 head	Takeo, Kampong Cham, Prey Veng, Svay Rieng, Kampot, Kandal
Pigs	2,688,612 head	Svay Rieng, Prey Veng, Kampong Cham, Kampong Speu, Kandal

Source: MAFF, Agricultural Statistics 2005-2006

[18] Estimated by CIDS based on statistics from NIS.

Domestic industry structure

The pre-existence of a relatively vibrant domestic food processing industry suggests that a little promotion could have a strong multiplier effect on the whole sub-sector. According to the most recent industrial survey by the Ministry of Industry, Mines and Energy (2004), there are at least 22,712 food processors in Cambodia[19]. The majority (10,000+ establishments) are micro enterprises with 1-3 employees per establishment. There are about 1,000-5,000 small enterprises, each employing about 3-20 workers, and about 50-100 medium-scale operations, which hires about 20-100 workers on average. There are a few large businesses (around 20-50 operations), consisting of 100-1,000s workers. Products are diverse and include pickled vegetable, local wine, milled grains, noodles, fish/soy sauce and bakery (see Table 12).

Table 12: Domestic Industry Structure of Food Processing

Scale	Market Focus	Product Focus	Typifying Characteristics
Big business	Export and National	Cassava, rubber, palm oil, cattle for export, flour milling, chicken and hog farms, silk imports, rice (1 or 2), flash-frozen fish exports, seafood exports, live fish exports, grains (exports)	Influential relationships critical Purchase of market function Monopolistic Plantation scale Very few entrepreneurs (Ohkyas) Not overly successful at exporting Poor supply chains, extract high rents Only one or two operations per industry Large-scale investment ($ and land)
Medium	National	Fish and soy sauces, rice (10-20), cashews, processed and packaged foods, fish farms, crocodiles, noodles, grain milling, fertiliser manufacture (if any)	Influential relationships important Many consolidating industries Compete with Viet and Thai products Government agents as entrepreneurs Few up-to-date processing investments Export potential, but lack quality Chinese-Khmer based businesses
Small	Cross-provincial	Bread, bakeries, soy and fish sauce, soybean cake (tofu), local wines, distribution services – transport, marketing-middleman, packaging (glass), bottle and package consolidation and delivery, machinery, grain milling	Influential relationships not essential Moderate barriers to entry ($, skills), so new businesses pop up and close down Mostly begin as family business Many women involved Local competition, but negatively impacted by imports Local-provincial brand recognition
Micro	Local	Pickled cabbage, mango, rice cakes, honey, soy milk, spiders, Cambodian confections, input supplies, bottle collecting, machinery repairs, collection and distribution services (moto), fruit consolidators	Influential relationships unnecessary Almost no barriers to entry (low skill, low capital investment) Low capital investment Local branding, if any Opportunity-based

Source: Schmitt-Degenhardt, S., Kang, C. et al. (2005). Development of SMEs in the Agro-Industry Sector, Cambodia Study and Survey on Business Development Services in particular for SMEs in rural areas for the agro-industry in Cambodia. Report for EU Commission, GTZ and MPDF.

[19] MIME (2004). *Small Industrial Establishment Survey*. Phnom Penh Cambodia: MIME

Local value-added potential

For products that are locally processed, there is a lot of space for increasing value added. Compared to international standards, local products are on the low value end, mostly because quality is still low. Value added could easily be increased simply by introducing local processors to improved machines and equipments. Promotion of packaging could also help improve the appeal of products, and possibly, its value.

Related and Supporting Industries

The **expanding hotel and restaurant sub-sector** could definitely serve as a market for processed food. The most readily available government statistics on the number of hotel and restaurants dates back to 2000, of which there were an estimated 371 hotels and restaurants in the country. To date, there are 1,291 restaurant listings in Yellow Page and 287 hotel listings. The actual number of hotel and restaurant businesses is much higher than these figures if we were to include the small, informal businesses.

Also, the **emergence of a home appliance market** in major metropolises such as Phnom Penh, Siem Reap and Battambang could also support the growth of the food processing industry. For instance, refrigerators help increase the lifetime of processed food, which could encourage households to purchase more products.

Development Objectives

Food processing is generally a labor-intensive activity. As of 2006, the sub-sector employed at least 218,300 workers, of which about 40 percent are women.[20] Since the industry does not require highly specialized skills at this stage, it is possible to integrate retrenched garment works into this type of activity.

Constraints to Growth of Food Processing Industry

To understand the constraints faced by local food processors, CIDS conducted in-depth interviews with local public officials and authorities. Based on these interviews, we compiled the following list of constraints:

- national policy primarily focused on large, export-oriented businesses, leading to limited attention or interest in agricultural processing and agricultural development
- potential for agro-processing but disconnected value chain and little investment promotion a constraint
- no packaging industry

[20] Estimated based on SME Survey (2005) of 2,015 enterprises in three provinces (see Kang (2005)). Data from the Industrial Establishment Survey of the Ministry of Industry, Mines and Energy (2000) also leads to similar estimates.

- agriculture collection system weak, especially because farmers produce different breeds and types of products; no coordination between farmers
- low quality of agriculture products, does not meet market standards, thus difficult to use for processing (e.g. mung beans)
- unreliable supply of inputs / raw materials
- do not know how to process agriculture products and what market demands
- lack of capital for processors to expand business
- producers use second-hand machines/equipments, which are obsolete, results in low quality products
- production based on tradition, not technique or standard
- difficult to obtain capital for financing new or improved equipments/machines because of high interest rates
- no system in market, difficult to identify fake products
- market info system weak, especially because lack of technology and equipment

IV. Proposed Policies at the Provincial Level

The *Rectangular Strategy*, which is the national economic policy framework, provides **high freedom to provincial policymakers to design policies that respond to their specific development needs as it relates to a wide range of priority sectors** (for a summary of the framework for industrial and employment policies, see Box 7). In other words, provincial policymakers face no constraint in developing industrial and employment policies.

Box 7: Framework for Industrial and Employment Policies as Outlined in the Rectangular Strategy

Investment and enterprise development
- Access to international markets by: 1) implementation of policy of economic integration, 2) development of both software and hardware national infrastructure networks, and 3) strengthen legal framework for enterprise
- Enable environment conducive to private sector development by: 1) strengthening public and corporate governance, 2) facilitating trade and improving investment climate, and 3) human resource development
- Priority sectors for investment promotion: 1) agriculture and agro-industry, 2) transport and telecommunication, 3) energy and electricity, 4) labor-intensive industries and export-oriented processing and manufacturing, 5) tourism-related industries and 6) human resource development
- Promotion of SME

Employment creation
- Policy aimed at 1) creating more jobs, especially for young people, 2) establishing skills training networks for the poor, linked to employment assistance, 3) developing a labor statistical system.

Paraphrased from *Rectangular Strategy, 2004*

Since provinces differ in economic and socio-economic structure, the priority of sectors and policies will also differ. For provinces that are highly dependent on the garment industry, policies need to specifically consider industrial and employment alternatives to the garment industry, especially on absorbing retrenched garment workers. According to our macroeconomic analysis in the previous chapter, **provinces dependent on the garment industry should target their policies on the food processing and hotel and restaurant sub-sectors** because these sub-sectors have the highest potential to absorb employment and generate economic growth.

In this project, we focus on three provinces that are highly dependent on the garment industry for income and employment: Kandal, Kampong Cham and Kampong Speu. The results of our macroeconomic analysis give policymakers in these provinces a clear view of the sub-sectors with the highest potential; however, **each province may choose different sectoral focuses based on their specific geographic and socio-economic circumstances** (i.e. focus on one sub-sector, both sub-sectors, and/or specific branches within these sub-sectors). Table 13 lists some of the geographic and socio-economic characteristics of the three provinces and offers some recommendations on sectoral focus.

Table 13: Proposed Sectoral Focus for Kampong Cham, Kampong Speu and Kandal Provinces

	GEOGRAPHIC AND SOCIO-ECONOMIC CHARACTERISTICS	PROPOSED SECTORAL FOCUS
KAMPONG CHAM	▪ high availability of fruits and agricultural crops ▪ fertile soil ▪ relatively high education ▪ experience with modern technology and machines ▪ growing domestic and international tourism sector	▪ food processing ▪ hotel and restaurants
KAMPONG SPEU	▪ predominately agriculture ▪ little to no education ▪	▪ food processing
KANDAL	▪ rapidly growing metropolis that is attracting domestic and international tourists ▪ relatively high education ▪ gateway between Phnom Penh and provinces	▪ hotel and restaurants

Regardless of the sectoral focus, it is proposed that industrial and employment policies to promote the selected sub-sectors should cover both the supply and demand. Supply-side policies include those relevant to investment and production, while demand-side policies refer to those relevant to the market. On the supply side, there are three main components to consider: provincial investment climate, provincial business operation climate and access to finance (see Box 8 for more details on these issues). On the demand-side, market connection or trade facilitation is the most important issue. Provincial policymakers may want to keep a close watch on domestic and international trade facilitation; although, it does not need to be at the top of their policy agenda because there are many efforts to improve this component at the national level.

Box 8: Proposed Coverage of Policies

Investment Climate
- infrastructure
- public service and institutions
- tax policies

Business Operation Climate
- skills of labor
- modern technology, machines and equipments
- input supply
- business development services

Access to Finance
- land titling
- collateral
- credit information system

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List of People Met

Date of Consultation	Name / Position / Institution
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June 14, 2007	Mr. Chheang Chhay, Deputy Director, Department of Commerce, Kampong Cham Province, Tel: 012-974-476
June 14, 2007	Mr. Suy Dy, Deputy Director, Department of Industry, Mines and Energy, Kampong Cham Province
June 14, 2007	Mr. Heng Binkhe, Director, Department of Agriculture, Kampong Cham Province, Tel: 012-395-039