





# 1 BACKGROUND

Dollarization presents both benefits and challenges for the Cambodian economy. On the positive side, it fosters growth in the financial sector, enhances economic and financial integration with the global market, limits inflationary financing of fiscal deficits, encourages financial discipline, and helps preserve consumer purchasing power. However, it also leads to the loss of seigniorage and diminishes the effectiveness of monetary policy and exchange rate management.



Cambodia's dollarized economy emerged in the 1990s, primarily due to political instability and the substantial influx of foreign aid in United States Dollar (USD). Despite various efforts by the government, especially the National Bank of Cambodia (NBC), to promote the use of Khmer Riel (KHR), USD remains dominant in the private sectors. In particular, the garment sector continues to rely heavily on USD for wage payments. This reliance on USD poses challenges for low-income households, who earn in USD but spend largely in KHR, resulting in potential welfare losses due to currency mismatches. Hence, further measures are needed to enhance KHR's role in wage payments within the private sector. The United Nations Development Programme (UNDP) and NBC commissioned this study to examine the dollarization issue in Cambodia, focusing on the garment, footwear, and travel goods and bag sector of the country through analysing the impact of currency mismatches on household welfare, assessing the landscape of currency usage in the surveyed sector, and examining the perceptions of wage payments in KHR of respondents from both worker and factory sides.

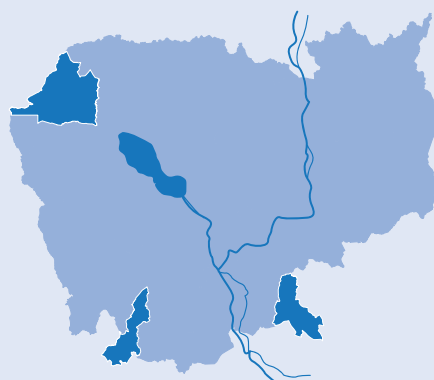
# 2 METHODOLOGY

## SAMPLE SIZE AND SAMPLING TECHNIQUE

Structured surveys were conducted with factory workers and employers across Phnom Penh capital city and four other provinces (Banteay Meanchey, Svay Rieng, Preah Sihanouk, and Kandal).

Data was collected through random sampling between March to May 2023, with 10-20 workers per selected factory resulting in responses from 1,068 workers 888 of whom were women. The garment sector employed the largest share of workers, with most residing in Phnom Penh. The survey covered 114 factories in the garment, footwear, and travel goods sectors.

Of these 42 factories were in special economic zones (SEZs) across three provinces (Preah Sihanouk, Svay Rieng, and Banteay Meanchey), while 72 were outside SEZs.



## ANALYTICAL TECHNIQUES

The following theoretical model and analytical methods were applied:


- Descriptive statistics was conducted to illustrate socio-demographic characteristics, income and expenditure, and perceptions of wage payments in KHR.
- A utility maximization model following Arkolakis et al. (2012) was used to assess the welfare effect of currency mismatches in transactions.
- Regression analysis, specifically a Probit Model, was employed to identify determinants of perception on receiving wage in KHR

# 3 KEY FINDINGS

## 3.1. FINANCIAL LANDSCAPE

### HOUSEHOLD INCOME AND EXPENDITURE



 **88.0%** of household income is in USD, but

 **87.6%** of the total expenditure is in KHR.

Income of the surveyed households primarily comes from salaries and wages, making up about 98.6% of total income, mostly received in USD. Agriculture contributes only 0.1% to income, primarily in KHR, reflecting the focus on factory employment. Business activities account for 0.7% of income, mostly in KHR, with a smaller portion in USD. Casual jobs add **0.5%** of income,

mainly in KHR but also in USD and Thai Baht (THB). Remittances contribute **0.2%** of income, mostly in KHR. Overall, **88%** of household income is in USD.

Household expenditures are primarily spent on food and beverages (44.1% of total expenditure), remittances to family (14.9%), and other expenses like wedding receptions (12%). Housing (rent) accounts for 10.2% of total expenditure, while transportation, utilities, and personal care are under 6%. Most expenses are paid in KHR, especially for transportation and personal care. Rent is an exception, with 67% paid in USD. Communication expenses have a notable 15.5% in USD. Overall, household spending is predominantly in KHR (87.6%), with 12.3% in USD and a negligible amount in THB.

The results suggest a currency mismatch between household income and expenditure in different currencies (KHR, USD, and THB). The majority of income, especially salaries and wages, is predominantly in USD (about 88%), whereas the majority of expenditures, such as food and beverages (about 99.9%) and transportation (100%), are predominantly in KHR. This disparity can expose households to currency mismatch and exchange rate risks and may have an effect on their welfare.

**Table 1. Shares of household income (month) by source and currency type**

	Share in total income (%)	Share in KHR (%)	Share in USD (%)	Share in THB (%)
<b>Income sources</b>				
Agriculture	0.1	91.7	0.0	8.3
Business activities (wholesale, retail sale, etc.)	0.7	93.5	6.3	0.1
Salaries/wages	98.6	10.9	89.1	0.0
Other casual works (agriculture, retail business, etc.)	0.5	77.3	18.2	4.5
Remittances	0.2	76.3	20.0	3.7
<b>Total (N=1,068)</b>	<b>100.0</b>	<b>12.0</b>	<b>88.0</b>	<b>0.0</b>
<b>Expenditure components</b>				
Food and beverages	44.1	99.9	0.1	0.0
Housing (rent)	10.2	33.0	67.0	0.0
Water and electricity	3.0	98.6	0.4	1.0
Communication (phone card, internet, etc.)	2.8	84.5	15.5	0.0
Transportation	5.2	100.0	0.0	0.0
Personal care (soap, toothpaste, sanity, etc.)	2.8	99.4	0.6	0.0
Remittance to family members	14.9	81.6	18.4	0.0
Clothing and footwear (clothes, shoes, etc.)	2.7	95.2	4.7	0.1
Medical care (medical services, drugs, etc.)	2.3	98.7	1.3	0.0
Other expenses (parties, ceremonies, etc.)	12.0	93.6	6.2	0.3
<b>Total (N=1,068)</b>	<b>100.0</b>	<b>87.6</b>	<b>12.3</b>	<b>0.1</b>

## FACTORY SALE AND EXPENDITURE



**85.4%** of the factory's expenses are paid in USD, with building rental costs fully (**100%**) paid in USD.

Factory sales revenues in both Phnom Penh and the selected provinces are entirely in USD.

Wage payments constitute the largest share of factory expenditures, averaging about 55% of total sales and 82.2% of total expenditures.

Most wage payments (89.8%) are made in USD, with only 10.2% in KHR. Factories prefer paying wages in USD to align with their sales revenues and minimize currency conversion issues.

Utilities account for about 3.3% of total sales and 5.5% of total expenditures, with 76.4% of these payments in USD.

All building rent transactions are paid in USD, representing about 4.2% of sales and 7.7% of expenditures. Contributions to the NSSF and pensions account for 2.6% of sales and 4.2% of expenditures, entirely in KHR.

Other expenses, such as maintenance, comprise about 0.3% of total sales and 0.4% of total expenditures, with 84.7% in USD. Overall, expenditures represent 64.8% of total sales, with 85.4% of total expenditures made in USD.

**Table 2. Shares of factory expenditure (year, excl. tax payment) by component and currency type**

Expenditure components	Share in total sale (%)	Share in total expenditure (%)	Share in KHR (%)	Share in USD (%)
Salaries/wages payments	55.0	82.2	10.2	89.8
Utilities (electricity, water)	3.3	5.5	23.6	76.4
Building rent	4.2	7.7	0.0	100.0
National Social Security Fund (NSSF) and pensions	2.6	4.2	100.0	0.0
Other	0.3	0.4	15.3	84.7
<b>Total (N=114)</b>	<b>64.8</b>	<b>100.0</b>	<b>14.6</b>	<b>85.4</b>

## 3.2. CURRENCY MISMATCHES AND WELFARE LOSSES

### HOUSEHOLD IMPACT AND EXCHANGE BURDEN



Workers assume **100%** of the cost of wage currency conversion.

Households lose around **1.2%** of their income due to currency mismatches.

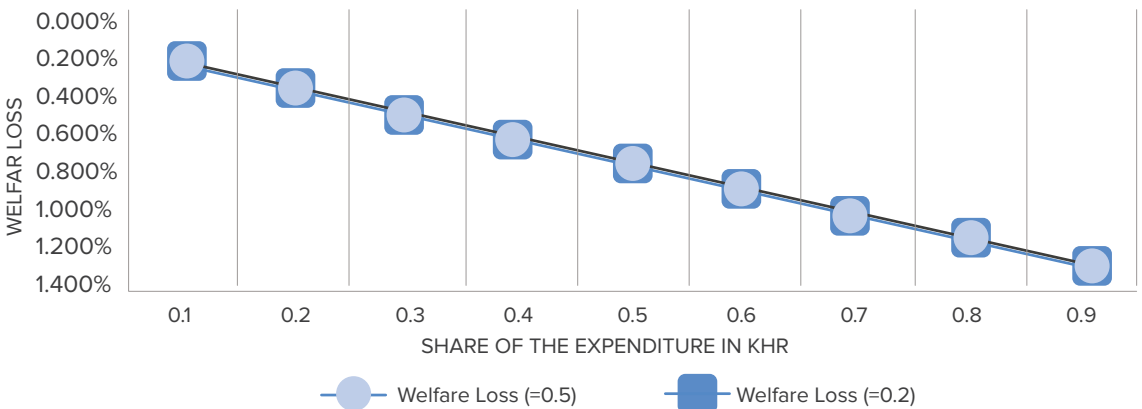
The losses are more pronounced for low-income workers who spend a significant proportion of their income in KHR.

The results indicate that households earning in USD but spending primarily in KHR experience welfare losses due to the additional costs of currency exchange. Surveyed households lose approximately 1.2% of their income due to currency mismatches, as about 90% of their expenses are in KHR.

These losses are more pronounced for low-income workers who spend a significant proportion of their income on necessity goods like food.

Given the cost of currency mismatches in transactions, the results indicate that, for a household whose income is in USD, the higher the share of household expenditures in KHR, the greater the welfare loss. The results also indicate that the impact is larger when the elasticity of substitution between USD and KHR is higher since households exhibit high flexibility in shifting between spending in USD and KHR (Figure 1).

**Figure 1. Welfare loss of currency mismatch in transaction**



Note: Since it is not possible to directly estimate the elasticity of substitution ( $\epsilon$ ),  $\epsilon=0.5$  and  $\epsilon=2$  was assumed. 1.4% transaction cost ( $\theta=1.4\%$ ) for the customer due to a currency mismatch in the transaction was estimated.

### 3.3. PERCEPTIONS OF WAGE PAYMENTS IN KHR

#### WORKER-SIDE PERCEPTION AND DETERMINANTS

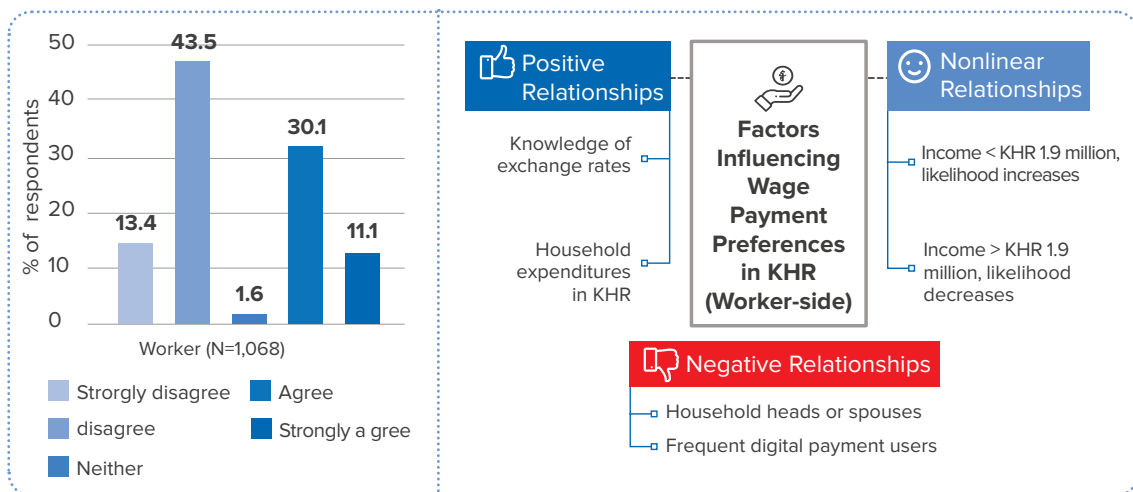


**41.5%** of the workers are keen to receive their wages in KHR. Workers in richer households prefer wages in USD.

The survey shows that 57% of workers oppose receiving wages in KHR, while 41.5% support it, with a small percentage remaining neutral. Regression analysis indicates that workers with better currency exchange knowledge and higher household expenses in KHR are more likely to accept wages in KHR, highlighting the importance of financial literacy in the de-dollarization process. Higher-income households generally express a greater willingness to receive wages in KHR; however, this willingness diminishes as income levels rise above a certain threshold, over KHR 1.9 million per month.

This suggests a non-linear relationship between income levels and preference for KHR payments. Conversely, household heads, their spouses, and frequent digital payment users are less inclined to receive wages in KHR, possibly because digital payments already offer fair exchange rates, minimizing the perceived need for wages in the local currency (Figure 2).

**Figure 2. Workers' perceptions on receiving wage in KHR (left) and determinants using probit model (right)**



# FACTORY-SIDE PERCEPTION AND DETERMINANTS



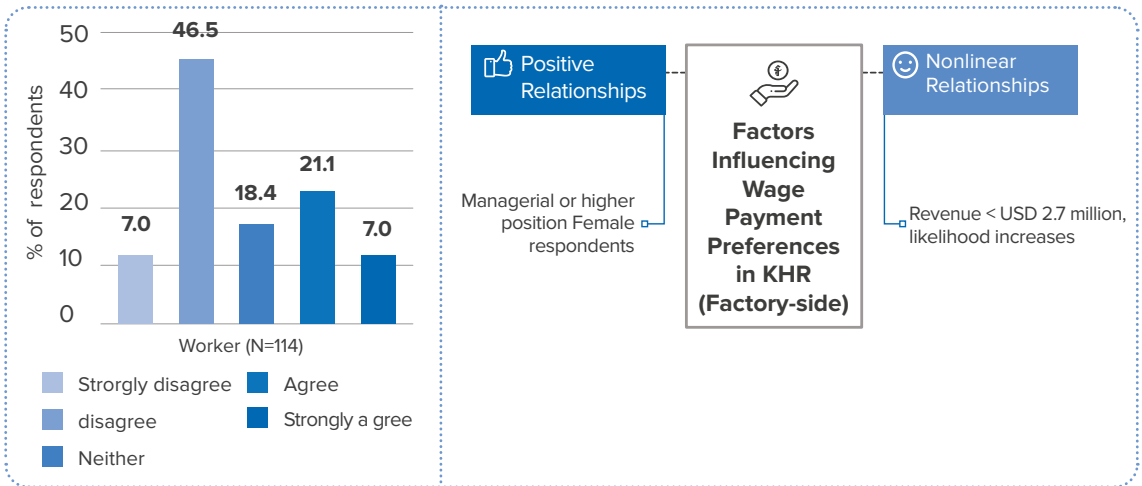
Majority of the employer are reluctant to pay employee’s wage in KHR. Only **28.1%** of the factory-side respondents are willing to pay wage in KHR.

The survey reveals that 53.5% of respondents disagree on paying wages in KHR, while approximately 28.1% of respondents indicated that they “agree” or “strongly agree”, with a significant number remaining neutral.

Respondents who are in managerial or higher positions and women are more likely to favour paying wages in KHR, possibly due to women having more knowledge on household expenses that are often in KHR.

The analysis also shows a nonlinear relationship between factories’ sales revenue and support for paying wages in KHR; the likelihood increases with revenue up to USD 2.7 million annually but declines for factories with annual sales exceeding USD 2.7 million (Figure 3).

**Figure 3. Factories’ perceptions on paying wage in KHR (left) and determinants using probit model (right)**



# REASONS OF AGREEMENT AND DISAGREEMENT



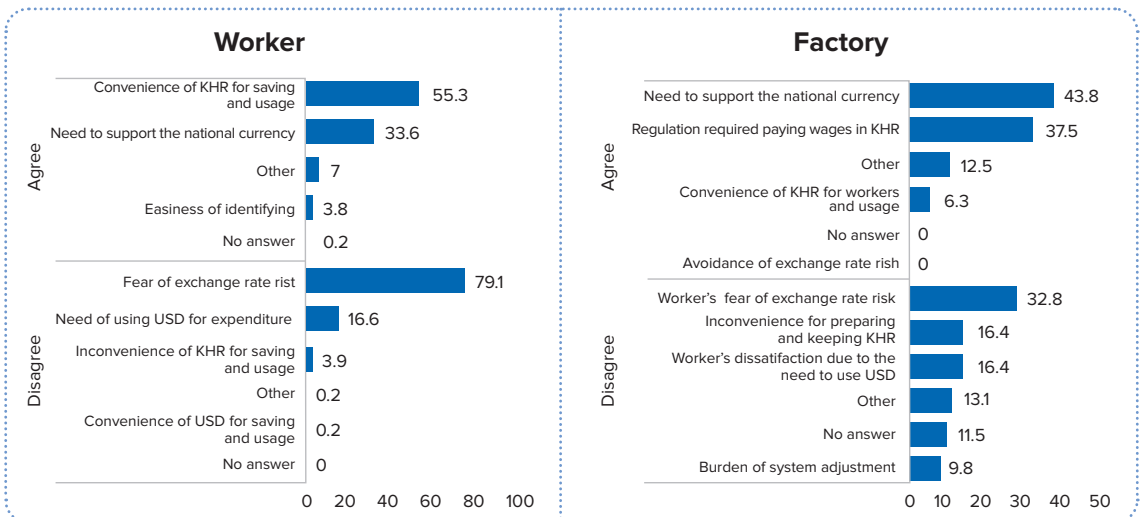
Fear of exchange rate risks is the major concern on receiving and paying wage in KHR.

The survey results show that 79.1% of respondents who oppose receiving wages in KHR stated so due to fears of exchange rate

risk, while 16.6% prefer using USD for their expenses, and 3.9% find KHR inconvenient for saving and usage. On the other hand, 55.3% of those who support receiving wages in KHR express its convenience for daily transactions and savings. 33.6% express a desire to support the national currency, with a few citing other reasons like the ease of identification (Figure 4, worker-side).

32.8% of factory-side respondents oppose paying wages in KHR due to workers' fear of exchange rate risks. Another 16.4% cite workers' preference for USD for expenses and the inconvenience of handling KHR as reasons for their opposition, while 9.8% mention the burden of system adjustments. 43.8% of those who agree mentioned that they are supporting wage payments in KHR to promote the national currency, and 37.5% cite if there are regulatory or policy requirements they would pay. A smaller group, 6.3%, supports KHR for its convenience for workers and usage (Figure 4, factory-side).

**Figure 4. Reasons of “agree” or “disagree” on wage payments in KHR**



# 4 RECOMMENDATIONS

The transition to using KHR for wage payments in Cambodia's garment sector presents a significant opportunity to reduce the negative impacts of currency mismatches, particularly for low-income households. Promoting KHR usage is essential for reducing welfare losses and strengthening national economic stability. However, the primary reason that workers and factory management oppose KHR wage payments is the fear of exchange rate losses, despite the relative stability of the KHR exchange rate over the past decade. While factories prefer paying wages in USD to match their revenues, which are largely denominated in USD, thereby minimizing the risk of financial losses due to currency conversion. The recommendations below provide specific to general policy options to promote the adoption KHR-based payments.



**R1. Providing worker's freedom of choice.** The government should introduce a regulatory framework that allows workers to choose their preferred currency for wage payments, with the option to allocate specific portions in both USD and KHR. This flexibility would enable workers to manage their finances more effectively in a dual-currency economy. The framework should ensure transparency and fairness, providing clear guidelines for both employers and employees.



**R2. Promoting digital wage payments.** The government should collaborate with factories, banks and fintech companies to promote digital wage payment systems in factories and businesses. This can modernize wage payments, making them more secure and efficient, while reducing reliance on cash transactions. Investing in digital platforms that support KHR transactions with real-time, transparent exchange rates would benefit both workers and employers.



**R3. Enabling major expense in KHR.** The government should introduce incentives and a regulatory framework that encourages major expenses, such as housing, building rentals, and communication services (e.g., phone cards, internet), to be paid in KHR rather than USD. By shifting these significant costs to KHR, both employers and employees would have a stronger incentive to adopt KHR wage payments, thereby fostering greater use of the local currency in everyday transactions.



**R4. Targeting lower paid workers.** The findings suggest that households with an income of less than KHR 1.9 million per month are more willing to receive wages in KHR, as a significant portion of their income is spent in KHR. This provides an opportunity to introduce KHR wage payments to lower-paid workers, such as junior factory workers, cleaners, and security guards, who often deal with expenses in the local currency. In contrast, further research is needed to assess the willingness and concerns of higher-paid and office-based workers regarding such a transition.



**R5. Enhancing KHR stability. A stable exchange rate is crucial for fostering trust in the KHR.** By ensuring exchange rate stability, the government can promote wider acceptance of KHR for wage payments and minimize the negative effects of currency mismatches. Maintaining an exchange rate between 4000 and 4100 KHR per USD would encourage households to spend more in KHR, thereby increasing their willingness to receive wages in the local currency.



**R6. Financial literacy and awareness campaigns.** Enhancing workers' and employers' knowledge of the exchange rate and the benefits of KHR usage can significantly influence their willingness to transition to KHR wage payments. Tailored financial literacy programme should be prioritised and expanded countrywide to increase understanding of currency stability, currency mismatches and other practical advantages of using KHR. Large-scale campaigns, such as “Riel Day,” should be expanded with targeted focus on low-income households to emphasize the importance of KHR in national pride, economic sovereignty, and the reduction of dependency on foreign currencies.



**R7. Policy support for KHR wage payments.** The government should introduce policies for a gradual transition to paying wages in KHR, allowing businesses to adjust without facing immediate financial challenges. A supportive regulatory framework should also be developed, offering incentives such as tax benefits or reduced transaction fees for businesses adopting KHR payments. Additionally, the government should encourage voluntary adoption of KHR for wage payments by providing incentives for businesses that promote its use. To further support this transition, the National Bank of Cambodia (NBC) could offer incentives to financial institutions and households for adopting KHR for loans and savings, addressing current constraints caused by the use of USD.

# ACKNOWLEDGMENTS

The United Nations Development Programme (UNDP) would like to thank the organizations and individuals who contributed directly or indirectly to this Policy Brief. We would also like to thank the National Bank of Cambodia (NBC), particularly Dr. Khou Vouthy, Assistant Governor and Director General of Policy and International Cooperation, Dr. Lay Sokheng, Assistant Governor and Director General of Regulation, Financial Inclusion, Financial Literacy, Consumer Protection, and Sustainable Finance, and Dr. Mon Sreyleak, Senior Economist, for their strategic guidance and inputs.

The Policy Brief is prepared by Dr. Khoy Rada, Economist, UNDP Cambodia. It is based on the findings and recommendations of the UNDP report on “Dollarization and Its Effects in the Garment, Footwear, and Travel Goods and Bag Sector in Cambodia” produced by Dr. Oum Sothea, UNDP Consultant. The text and analysis have benefited from the reviews and contributions by the UNDP team, namely, Mr. Enrico Gaveglia, Resident Representative, Ms. Alissar Chaker, former Resident Representative, Mr. Shakeel Ahmad, Deputy Resident Representative, and Dr. Iván Gonzalez de Alba, former Senior Economist.

Thanks to Ms. Iv Ek Nimnuon, Assistant Resident Representative, Ms. Nith Ponika, Project Coordination Officer, and Ms. Khiev Thida, Programme Associate, from UNDP for providing coordination and management support with the relevant stakeholders.

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