

THE GLOBAL ECONOMIC DOWNTURN: OPPORTUNITY OR CRISIS?



អង្គការសហប្រជាជាតិកម្ពុជា
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FOREWORD



Cambodia has not escaped the impact of the global economic downturn. Poverty estimates produced in 2007 showed a poverty rate of 30 percent, an improvement from 35 percent in 2004. Helped largely by high economic growth of an average of 9.5 percent in the last decade, this is a remarkable achievement. However, Cambodia's progress in poverty reduction and towards achieving the Cambodia Millennium Development Goals (CMDGs) is under threat as a result of the impact of the economic downturn.

In this report, *The Global Economic Downturn: Opportunity or Crisis?*, researchers have drawn on existing surveys and literature, as well as interviewing policy-makers and talking to people on the ground. The report focuses on existing and potential vulnerable groups of people and the role that policy can play in alleviating these vulnerabilities as well as preparing for sustainable and equitable economic recovery.

The economic downturn presents an opportunity for the development of a national social protection system and for more urgently undertaking needed structural reforms to strengthen the economy's foundation. At the same time, it presents serious challenges in protecting existing achievements and sustaining people's livelihoods now and in the future.

The UN in Cambodia is concerned primarily with human development and the impact of the economic downturn on people, particularly the most vulnerable. Recent economic trends are having a significant impact on women as a result of the closure of garment factories, increasing the vulnerability of women. The economic downturn is also taking place at a time when over 250,000 young people are estimated to be joining the workforce annually. The macro-and micro-analyses that follow aim to take stock of current trends and to inform policy dialogue, while keeping in mind the most vulnerable groups.

A handwritten signature in blue ink, appearing to read 'D. Broderick'.

Douglas Broderick
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ACRONYMS



ADB	Asian Development Bank
ACLEDA	Association of Cambodian Local Economic Development Agencies
ASEAN	Association of Southeast Asian Nations
CAS	Cambodia Anthropometric Study
CDC	Council for the Development of Cambodia
CBHI	Community-based health insurance initiatives
CDCF	Cambodia Development Coordination Forum
CDRI	Cambodia Development Resource Institute
CMDGs	Cambodia Millennium Development Goals
EIC	Economic Institute of Cambodia
FDI	Foreign direct investment
GDP	Gross domestic product
GMAC	Garment Manufacturers Association in Cambodia
HEFs	Health equity funds
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
MAFF	Ministry of Agriculture, Forestry and Fisheries
MEF	Ministry of Economy and Finance
MFI	Micro-finance institution
MoC	Ministry of Commerce
MoEYS	Ministry of Education, Youth and Sports
MoH	Ministry of Health
MoLVT	Ministry of Labour and Vocational Training
MoSAVY	Ministry of Social Affairs, Veterans and Youth Rehabilitation

MoT	Ministry of Tourism
MoWRAM	Ministry of Water Resources and Meteorology
MRD	Ministry of Rural Development
NBC	National Bank of Cambodia
NSSF	National Social Security Fund
NGO	Non-governmental organisation
NIS	National Institute of Statistics
NPL	Non-performing loan
ODA	Official development assistance
PFM	Public financial management
RGC	Royal Government of Cambodia
SNEC	Supreme National Economic Council
SEZ	Special Economic Zone
UNDP	United Nations Development Programme
UNIAP	United Nations Inter-Agency Project on Human Trafficking
UNICEF	United Nations Children's Fund
UNTAC	United Nations Transitional Authority in Cambodia
WFP	World Food Programme

EXECUTIVE SUMMARY



Cambodia has not been spared from the pervasive impact of the global economic downturn. Based on information available through September 2009, gross domestic product (GDP) is forecast by the Asian Development Bank (ADB) to contract by 1.5 percent and by IMF to contract by 2.75 percent in 2009. This is a drastic shift following double-digit growth throughout most of the last five years. The sharp decline in GDP, in foreign direct investment (FDI) and in export income highlights now more than ever that Cambodia must take a more proactive and deliberate approach to diversifying its economic base and increasing its economic competitiveness. Addressing these priorities will strengthen its economic foundation and reduce Cambodia's high vulnerability to external shocks.

The economic and social impacts of the downturn in the past year have included significant job losses, reduced income for many households and a likely increase in food insecurity. This is mostly affecting the 30 percent of the population already living in poverty and the vulnerable near poor who are just above the poverty line. The direct impact on Cambodia is through its effect on the current major contributors to wages, employment and economic growth, namely FDI, the garment industry, the tourism sector, the construction industry and agriculture.

The garment sector contributes more than 70 percent to export income and is most illustrative of Cambodia's urgent need to diversify its economy. Garment exports to the US declined by 22 percent year-on-year in the first five months of 2009. Other garment producers such as Bangladesh, Viet Nam, and China actually increased garment exports to the US market over the same period, even though US garment imports had decreased by more than 12 percent during this time. The decline in Cambodian garment exports suggests a worrying lack of economic competitiveness for garments in Cambodia. The lack of diversification within the sector is also apparent with only five products composing 65 percent of garment exports in 2005, and with 90 percent of exports being sent to the US and EU. The negative fallout since September 2008 has included the net closure of 50 factories and the layoff of 63,000 garment workers, according to Ministry of Commerce figures, in an industry whose workforce is 90 percent women and predominantly from rural Cambodia.

The tourism sector, accounting for more than 13 percent of Cambodia's GDP, has started to show evidence of a decline or slower growth for the first time in more than a decade. Statistics for tourist arrivals show a shift from high-spending to lower-spending tourists, resulting in a substantial decline in tourism revenues. People dependent on tourism, especially in the tourism hub of Siem Reap, are earning much less income than last year. Many businesses in Siem Reap reported making less than half of what they earned a year ago, while a number of hotels have closed. This situation is also likely being negatively affected by the outbreak of Influenza A(H1N1) and the threat of political instability in Bangkok, a major route for tourists entering Cambodia.

In the agriculture sector, prices for agricultural products have declined sharply while farmers have had to incur high production costs for fuel and fertiliser due to high inflation in early 2008. This has caused a large number of farmers to lose income and fall into debt and poverty. In terms of household impact, there is a strong indication that many households have increased their indebtedness and are finding it increasingly difficult to make repayments. Furthermore, remittances to rural areas, which provided a significant contribution to the rural economy, have also declined as many migrants working in the cities or outside the country have either lost their jobs or are earning less.

It is estimated that about 20-30 percent of workers in garment factories, construction sites and the tourism industry have lost their jobs since late 2008. According to calculations in this study, this has resulted in losses of between US\$30-45 million in remittances. This is coming at a time when there is a need to create enough jobs for the annual entry of up to 250,000 new youths to the labour force as a result of population growth. The global economic downturn is an immediate threat to workers and their dependents.

This report identifies first order victims who are suffering the consequences of the downturn directly and rapidly (including workers in the garment industry, construction industry, tourism industry, farmers and migrants) and second order victims (including rural families receiving reduced remittances and returning migrants, poor children, existing urban poor and near poor and landless families) who are suffering the consequences in an indirect, but no less challenging manner.

One of the primary social impacts is that women are being more severely affected than men, largely due to the garment industry being one of the hardest hit. The United Nations Inter-Agency Project on Human Trafficking (UNIAP) conducted a survey of 357 girls and women working in the entertainment industry in April and May 2009 and found that the majority entered this industry after the global financial crisis took effect in September 2008. It appears that they chose these jobs because of limited employment options, made worse by low levels of education and training. The study found that indebtedness was a major cause for women to enter the entertainment sector, thereby increasing vulnerability.

The Royal Government of Cambodia (RGC) has been swift in responding to the negative impact of the global economic downturn. In terms of fiscal policy, the RGC is running a budget deficit of 4.8 percent of GDP in 2009. It suspended the monthly turnover tax of one percent on garment factory expenditures and extended the profit tax holiday for garment factories established prior to 2006. In May 2009, the Government provided, through the Rural Development Bank, a sum of US\$18 million in the form of loans to a number of rice millers to increase capacity to purchase and process paddy. Government revenue decreased by 11 percent for the first five months of 2009, compared to the same five months in 2008 and it remains to be seen whether the RGC will be able to meet its revenue target by the end of 2009. Less revenue will result in less available funds for expenditure. However, this report also identifies that the Government has savings of an estimated US\$600 million, thereby providing the option and manoeuvrability for fiscal expansion.

As advocated by the wider development community and in this study, Cambodia should seek to mitigate the impact of the crisis and strengthen the economy's long-term growth potential through diversification and effective public spending. This should focus on equitable access to any new spending programmes and should take into account existing institutional capacity. Existing social protection programmes run by both government and civil society are mitigating the economic downturn for some. However these programmes are patchy and fragmented and do not cover all vulnerable groups. This report strongly supports the development of a nationally integrated, inclusive social protection system, as advocated by the RGC in December 2008 at the Cambodia Development Cooperation Forum (CDCF), with clear leadership, good coordination and a strong institutional framework.

In addition, the economic downturn provides an opportunity for structural reforms in the area of economic competitiveness, diversification and agricultural productivity with a focus on preparing for long-term economic recovery that is sustainable and equitable, reduction of poverty and vulnerability and achievement of the Cambodia Millennium Development Goals (CMDGs) by 2015.



INTRODUCTION



It was initially expected that Cambodia would be insulated from the financial crisis due to its financial system being relatively undeveloped. This has proven not to be the case. In fact, since 2008 Cambodia has become one of the hardest hit countries in the region. Without a stock market, major short-term foreign debts or cross-border inter-bank liabilities, and portfolio investments, the Cambodian economy was not heavily exposed to the problem of short-term or liquid liabilities. Cambodia's vulnerability to the wider economic downturn, however, is evident through its heavy reliance on garment exports, largely to the US and EU markets, and by its reliance on tourism, particularly in Siem Reap province. FDI has been concentrated on these two sectors as well as in the construction sector, which has been further hit by negative trends in the world property market. The economy is therefore directly affected as a result of its narrow economic base and the lack of a vibrant rural economy.

The contraction of the manufacturing and services sectors has resulted in the loss of tens of thousands of jobs, mostly affecting people from rural areas. A large proportion of laid-off workers are expected to return home from the cities to rural households. The rural sector, where 90 percent of the poor reside, suffers from under-investment and under-development as evidenced by one of the lowest agricultural productivity rates in the region. Since many households will no longer receive remittances from urban areas as a result of the economic crisis and will be receiving laid-off workers, there will be increased pressure on the rural economy, which is itself under pressure due to the decline in agricultural commodity prices.

Rather than pinpointing the causes of the global economic downturn, this study assesses the current challenges and opportunities affecting Cambodia, and then attempts to find solutions. A large number of problems have been caused by a combination of external and internal factors. The global financial and economic crises have compounded these factors and revealed existing structural challenges within the Cambodian economy. Addressing these issues will enable Cambodia not only to speed up its recovery, but also to achieve faster growth and more equitable development in the medium- and long-term.

Section 2 begins with a review of the macro-economic impact of the global economic downturn, providing an analysis of economic growth and structural change in Cambodia. It then turns to the various transmission channels to Cambodia, including direct channels (various types of capital flows, remittances, ODA, etc.) and indirect channels (government budget, exchange rate, spending multipliers, returning migrant workers).¹ Section 3 examines the impact at the sectoral level, including on garment exports, tourism, agriculture and the property market and construction sector. It analyses existing data and current

¹ 'Spending multiplier' means that injecting an additional dollar of spending into the economy will cause output to increase by more than a dollar because there is a spending chain reaction. Likewise, taking a dollar of spending out of the economy will cause output to decrease by more than a dollar.

socio-economic literature on the Cambodian economy. Section 4 looks at the most vulnerable groups affected by the global economic downturn and the different types of vulnerabilities such as loss of employment, reduced incomes, reduced remittances, the decline in nutrition levels and pressure on school attendance and child labour. People dependent on foreign markets or FDI, such as garment workers and construction workers, tend to be the first to suffer negative impacts. As a secondary effect, the impact of the crisis is putting more pressure on the rural economy as prices of agricultural products decline and remittances from urban areas drop off and workers return home.

This report recommends three strategies for policy-makers to consider. First, the importance of developing a nationally integrated social protection system in order to mitigate the impact of the economic downturn and enable a return to sustainable equitable growth in the long-term. Social protection, as an effective mitigating mechanism against the downturn, is explained and analysed in section 4.3. Section 5 then proposes certain policy recommendations including the development of a nationally integrated social protection system. Social safety nets, including cash transfers, in-kind transfers, and workfare are high on the policy agenda. However, there are challenges including the need for sustainable financing and resources, and operational challenges including limited national and subnational fiscal capacity, identification and targeting of beneficiaries, engagement of partners at the grassroots level, potential leakages within the system, achieving national coverage, monitoring and evaluating results and delivering quality services such as education and health.

The second strategy option is in the area of fiscal policy. Stimulus spending has become a popular course of action by governments around the world. This study suggests that fiscal stimulus spending or increased public expenditure is recommended as long as there is a focus on equitable access for the most vulnerable, and institutional capacity is taken into account. The study accounts for the typically undeveloped economic linkages between urban and rural areas, as well as the risk that certain types of spending could increase imports with little local stimulus, or alternatively, increase land prices and land concentration among the wealthy. Stimulus spending should be targeted at those who really need it.

The third area for consideration is structural reform, in the area of economic competitiveness, diversification and agriculture with a focus on long-term recovery and reduction of poverty and vulnerability. Today's economic circumstances provide the government with an opportunity to accelerate structural reforms. Reforms can offer both immediate and long-term benefits to the economy with its narrow base and limited domestic linkages. The need for improved competitiveness, better diversification and greater agricultural productivity has not arisen solely as a result of the economic downturn, but rather, economic circumstances have reinforced the urgent need to accelerate reforms in order to reduce vulnerabilities and prepare for economic recovery.



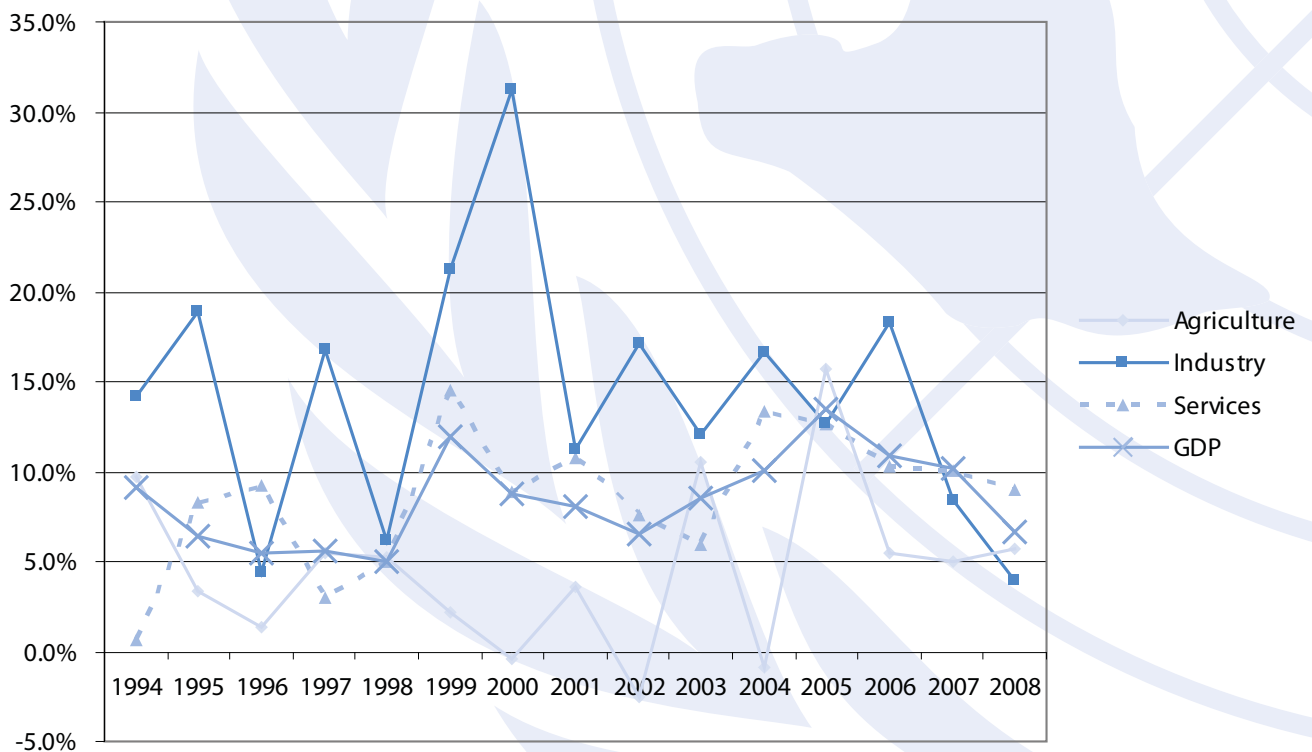
MACRO-ECONOMIC IMPACT



2.1. ECONOMIC GROWTH PROJECTIONS AND STRUCTURAL CHANGE

Before discussing the global economic downturn's impact on economic growth in 2009, it is worth reviewing the achievements of the past 15 years. After growing on average by 8.4 percent over the past 15 years and by double digits from 2004 to 2007, the Cambodian economy slowed to a modest 6.7 percent growth in 2008, with economic activities decelerating in the fourth quarter of 2008.² As illustrated in Figure 1, economic growth was driven by high growth in industry, mainly garment manufacturing. In addition, tourism services contributed substantially to the service sector, which helped accelerate GDP growth. Agriculture, which has been the primary livelihood for 70 percent of the population in the past decade or so, experienced the least growth and highest fluctuation.

Figure 1. Economic growth trends by sector (percentage, 1994-2008)



Source: National accounts produced by NIS, 2007 and 2009

² The National Institute of Statistics (NIS) estimated 6.8 percent for 2008. The final figure has not yet been released.

In December 2008, ADB, the International Monetary Fund (IMF), and the World Bank predicted that Cambodia's GDP in 2009 would grow at 4.7 percent, 4.8 percent and 4.9 percent, respectively. However, the numbers have since been revised sharply downwards to -1.5 percent, -2.75 percent and -1.0 percent, respectively (see Table 1). In December 2008, the Cambodian government projected 6 percent growth, and in July 2009 revised its prediction to 2.1 percent.³

Table 1. Cambodia 2009 GDP growth projections

	GDP growth projected in December 2008	Revised GDP growth projected in 2009
ADB	4.7%	-1.5% (Sept)
IMF	4.8%	-2.75% (Sept)
WB	4.9%	-1.0% (March)
RGC	6.0%	2.1% ⁴

Source: ADB, IMF, World Bank and MEF

There is consensus that the garment, tourism and construction sectors will contract. However, the level of contraction is widely disputed. Data from the first five months shows much higher contraction than predicted in late 2008. For instance, garment exports fell by 22 percent in the first five months of 2009 compared to the same five months last year. Tourism revenues declined substantially with the number of high-spending tourists dropping significantly in the first six months of 2009 compared to the same period in 2008.⁵ The construction sector, which relies heavily on FDI, has been experiencing a remarkable decline following the credit crunch in investors' home countries, combined with the burst of the real estate bubble. The recovery of these three sectors is directly linked to the recovery of the global market.

The level of garment exports depends largely on two factors, the US market and Cambodian competitiveness. The US imported 12.04 percent less garments during the first five months of 2009 compared to the same period in 2008. Interestingly, Bangladesh, Viet Nam and China exported more garments to the US market in the first five months of 2009, while Cambodia's garment exports to the US declined by 22 percent. The relative decrease in Cambodian garment exports compared to other countries indicates the need for Cambodia to rapidly increase the sector's competitiveness.

Agriculture is the only sector that is not predicted to decline in 2009, assuming there is no large-scale drought or flooding toward the end of the year. Since growth is based on actual production of crops with constant prices assumed, it is likely that it will grow by around 5 percent, as predicted by ADB. However, in terms of revenue, farmers could be worse off compared to 2008 because many crops now have lower prices. Farmers also encountered higher production costs, especially the costs of labour, machinery and fertilisers, in 2008, although prices have begun to fall in 2009.⁶ Many farmers incurred losses because of this mismatch between costs and revenues.

³ Communication with senior government officials.

⁴ Naron, H.E. Dr. Hang Chuon, Secretary General of the Ministry of Economy and Finance. Public Forum on the Impact of the Global Economic Downturn and the Need for Policy Responses. Cambodia-Japan Cooperation Center. 14 July 2009. Presentation.

⁵ Total visitor arrivals dropped by only 1.07 percent in the first six months compared the same months in 2008, but higher-end tourists arriving by air decreased by 16.21 percent. Visitor arrivals by air to Siem Reap and Phnom Penh dropped by 18.45 percent 13.37 percent during the same period, respectively. This was offset by arrivals by land and water. Visitors from Viet Nam and Lao PDR narrowed the gap in the number of arrivals but generally spent less money.

⁶ Chan, Sophal. "The Impact of High Food Prices". Annual Development Review 2008-09. Phnom Penh: Cambodia Development Resource Institute (CDRI), 2009.

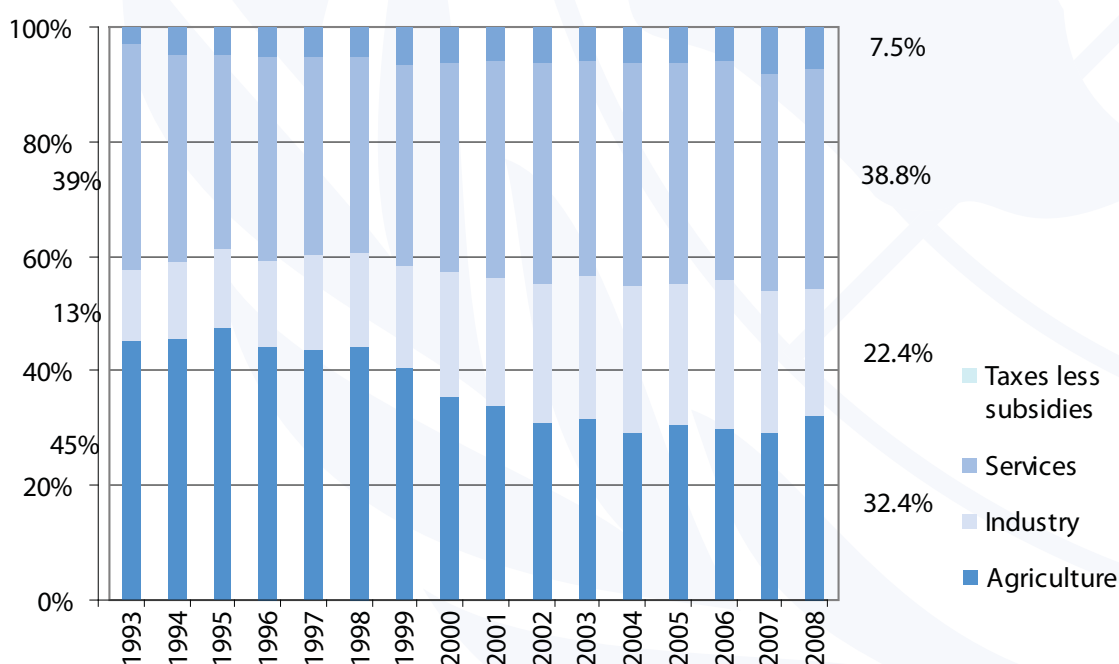
In light of these findings, economic output in 2009 is likely to contract. The economy's actual performance, especially in the garment, tourism, and construction sectors, has so far been worse than predicted. Although agriculture is likely to grow in real terms, the low productivity of agriculture and limited economic linkages means that the sector contributes much less than its potential to GDP.

Despite the negative developments outlined above, there are a number of positive indicators for the prospective medium-term growth of the Cambodian economy. The banking system has expanded, with considerable investment by a new Korean bank, Kookmin Bank, and a Vietnamese Bank, Sacom Bank.⁷ Despite the fact that savings are among the lowest in the region, deposits are rising, reflecting increased confidence in Cambodia's banking sector. The entry of these two banks has brought the number of Cambodia's commercial banks to 29. The high number of banks may make effective bank supervision more challenging. Infrastructure development, including the expansion of the Siem Reap airport and large resort projects in the same province, is also expanding and attracting FDI.

Structural reform

As is the case for many countries, the structure of the Cambodian economy has changed in recent years with the relative decline of agriculture and growth of the industrial sector. The contribution of agriculture to GDP fell steadily from 45 percent in 1993 to 30 percent in 2007, before it rose slightly to 32.4 percent in 2008 (see Figure 2). The share of the workforce declined from 75 percent to 56 percent in the same period. The industrial sector rose from only 13 percent of GDP in 1993 to 22.4 percent in 2008, while the employment share increased from 5 percent to 15.4 percent. The corresponding figures for the services sector are 39 percent and 38.8 percent, pushing the employment share up from 20 to 28.7 percent.

Figure 2. Structural change of the Cambodian economy (percentage change at current prices)



Source: National accounts produced by NIS in 2007 and 2009

⁷ Sovann, Nguon. "Sacombank launches with eye on VN trade". Phnom Penh Post 24 June 2009: 13.

Impressive economic growth over the past decade was supported by four main pillars: tourism, garments, construction and agriculture. One of the reasons for this high growth and structural change was the favourable access to garment export markets granted by the US and EU, which effectively resulted in the sudden garment factory boom. Growth in the tourism sector is largely attributed to the low initial base and the attraction of ancient temples such as Angkor Wat. Overall growth was made possible due to peace and macro-economic stability achieved by the RGC in cooperation with numerous development partners.

The main economic sectors of the Cambodian economy have expanded rapidly since the mid-1990s. Foreign tourists started to flock to the country in the late 1990s, after the country achieved peace and political stability. There were only 20,000 foreign visitors in 1992, but the number rose rapidly to 2,125,000 in 2008. Tourism receipts contributed more than 13 percent to the economy in 2008.⁸ The garment industry, at its peak in late 2008, employed 360,000 workers, mostly young female workers from rural villages, with almost 300 factories in 2008 after having started from only seven factories in 1994. Fuelled by investment from Korea and China, Cambodia experienced a construction boom for most of the last decade. Agriculture has always been the backbone of rural Cambodia and has grown considerably in the past decade. Growth in the agricultural sector is expected to continue while the other three sectors are projected to decline or stagnate in 2009.

The impact of the global economic crisis was beginning to be felt in Cambodia in the fourth quarter of 2008. The lack of diversification is repeatedly identified as a serious weakness.⁹ The global crisis has compounded these vulnerabilities created by relying too heavily on the garment industry, tourism services, and construction, all of which are directly connected to foreign markets and capital. With global demand for garments and the global tourism industry in decline, the Cambodian economy has received substantially less export revenue and experienced a large number of lay-offs. The RGC recognises that attention and investment in agricultural and rural development should be increased. The immediate priority is to prepare this sector to absorb laid-off workers from urban areas. The rural sector has a lot of development potential with vast potential for increased agricultural productivity, expansion of cultivated areas and improvement of processing capabilities.

A recent World Bank report found the following: (i) the economic growth of the past decade is unlikely to continue in its current form; (ii) with a focused growth strategy to increase competitiveness and diversify the economy, Cambodia can achieve sustainable growth; and (iii) Cambodia has the opportunity to harness regional integration, sustainably manage natural resources, and invest in its future (through agriculture, infrastructure, education, and higher savings).¹⁰

A recent United Nations Development Programme (UNDP) report reveals that Cambodia's competitiveness is among the lowest in the region in many areas, including skills and human resources, technology, infrastructure, regulations and institutions.¹¹ The study recommends that in addition to improving on these aspects, a new set of policies is required to consolidate growth in agriculture, the garment industry and

⁸ Ministry of Tourism 2008

⁹ See for instance, Cambodia Country Competitiveness: Driving Economic Growth and Poverty Reduction (Discussion Paper No. 7). Phnom Penh: UNDP, 2009; Sustaining Rapid Growth in a Challenging Environment (Cambodia Country Economic Memorandum). Phnom Penh: World Bank, 2009; Cambodia Human Development Report 2007: Expanding Choices for Rural People. Phnom Penh: UNDP, 2007; Cambodia: Halving Poverty by 2015? (Cambodia Poverty Assessment 2006). Phnom Penh: World Bank, 2006.

¹⁰ Sustaining Rapid Growth in a Challenging Environment (Cambodia Country Economic Memorandum). Phnom Penh: World Bank, 2009.

¹¹ Cambodia Country Competitiveness: Driving Economic Growth and Poverty Reduction (Discussion Paper No. 7). Phnom Penh: UNDP, 2009.

light manufacturing, tourism, construction and ICT. These policies include: embarking on a more proactive human resource development policy to increase the number of skilled workers in all sectors, a more targeted approach to industrial and investment policy (rethinking the Special Economic Zones or SEZs), implementing a targeted infrastructure policy and improving more regular application of the regulatory framework.

It is vitally important to lower business costs by increasing the percentage of formally registered firms in Cambodia. The private sector is still characterised by the overwhelming presence of micro-enterprises, most of which are informal. Micro-enterprises employing one to ten people accounted for 97 percent of the 63,507 firms counted in the census commissioned by the International Finance Corporation (IFC) and the Asia Foundation in 2008. The official National Institute of Statistics (NIS) nationwide “Establishment Listing of Cambodia from 9 February to 8 March 2009”¹² found 375,095 establishments in the whole country. Wage employment accounts for only 20 percent of total employment. Of these 63,507 firms, only approximately 20,000 have officially registered with the Ministry of Commerce (MoC), and even fewer pay taxes and produce official annual accounts. Lack of official registration can increase the cost of doing business.

2.2. GOVERNMENT BUDGET

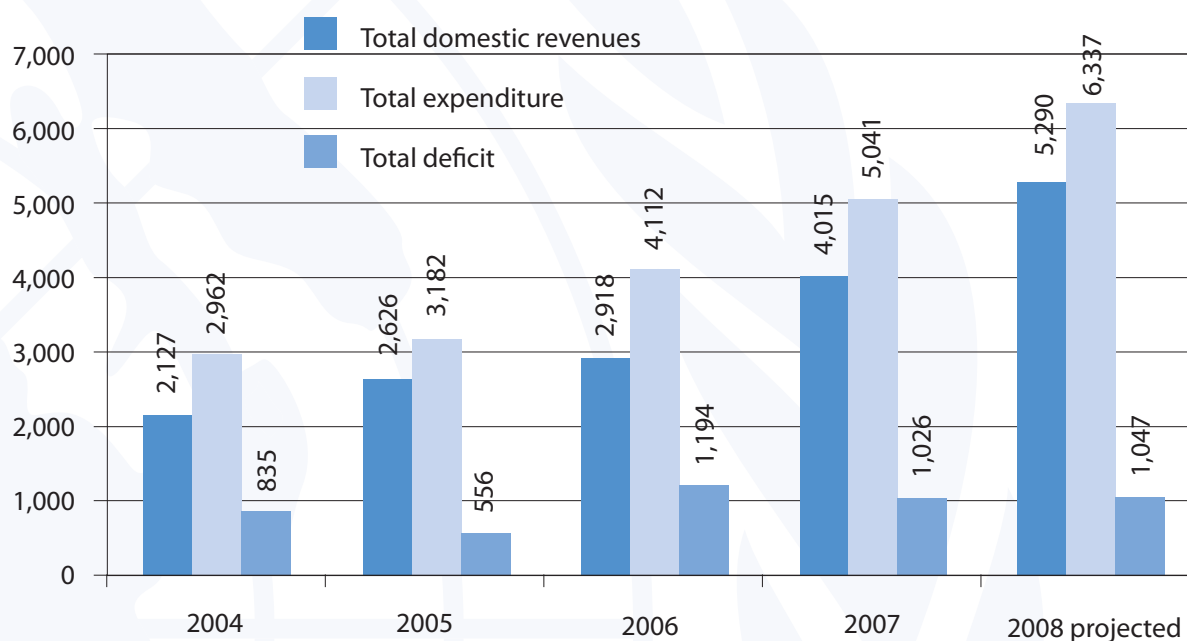
Government revenue, in absolute terms, has improved steadily due to the high growth of GDP and improvements in tax collection mechanisms. Tax revenues, as well as non-tax revenues, have been rising overall. Total revenue increased by 19 percent in 2005, 10 percent in 2006, 27 percent in 2007 and 24 percent in 2008. However, despite the success of the first stage of the public financial reform (PFM) programme, government revenue has been on average 12 percent of GDP for the past decade, compared with 16 percent on average in other Association of Southeast Asian Nations (ASEAN) countries. Tax has been the main source of government revenue, accounting for 72 percent to 84 percent of total revenue for the last five years.

Increased government revenue has enabled an increase in expenditure. Total government expenditure grew substantially, by 7 percent in 2005, 22 percent in 2006, 18 percent in 2007 and 20 percent in 2008. Expenditure in 2009 was projected to be 7,259 billion riel (US\$1.8 billion), 28 percent more than 2008 expenditure. The budget expansion was designed in mid-2008, before the country was hit by the global economic crisis. The RGC has considered this budget expansion to be a *de facto* stimulus package, in addition to increased spending on other targeted sectors.

The budget deficit has expanded in nominal terms from 835 billion riel in 2007 to 1,047 billion riel in 2008. In relative terms, the deficit fell from 28 percent of total expenditure, or 4 percent of GDP, to 17 percent of total expenditure, or 3 percent of GDP, from 2005 to 2008 (see Figure 3). The planned deficit for 2009 is 4.8 percent of GDP. Foreign financing contributes to the budget deficit as well as being used for government savings. As a result, by the end of 2008, the government had accumulated approximately US\$600 million (or 6 percent of GDP in 2008) as savings deposits at the central bank. This was meant to provide fiscal space for expansionary measures in times of crisis. These savings could be used to mitigate the impact of the economic downturn on the poor, as well as for improving the foundations of the Cambodian economy for long-term sustainable development.

¹² “The Preliminary Results of Nation-wide Establishment Listing of Cambodia 2009”. National Institute of Statistics/Ministry of Planning, 2009. <http://www.nis.gov.kh/index.php/statistics/surveys/el2009>, accessed 7 June 2009.

Figure 3. Government revenue, expenditure and deficit (in billions riel)



Source: MEF

The RGC has acknowledged that due to the global financial and economic crises, and the subsequent revenue shortfalls, achieving the targets set out in the 2009 budget would require considerable effort. Budget estimates have been conservative for the last five years, especially since the implementation of public financial management (PFM) reform. Actual revenue has substantially exceeded budget targets. Government revenue is expected to decline from 12 percent of GDP in 2008 to 11 percent in 2009. However, total expenditure is projected to increase, in real terms, from 14 percent of GDP in 2008 to 15.8 percent in 2009.

According to the Ministry of Economy and Finance (MEF), the 2009 increase in spending will only be achieved if the following projections are accurate:

- Revenue falls, in real terms, by 1 percent of GDP;
- Current expenditure increases from 8.5 percent of GDP to 9.5 percent;
- Capital expenditure increases from 5.8 percent of GDP to 6.3 percent;
- Locally financed expenditure, in nominal terms, increases by 23 percent;
- Externally financed expenditure increases, in nominal terms, by 11.5 percent;
- Current budget surplus reduces from 3.2 percent of GDP to 1.2 percent;
- Overall budget deficit increases from -2.2 percent of GDP to -4.8 percent;
- Foreign financing is 4.7 percent of GDP (not all official development assistance, ODA, is included in the budget; only investment-related technical assistance and investment expenditure are included in the budget. For 2009 only US\$462 million of the US\$950 million were included in the budget. Not all of the pledges will be disbursed, taking into account the absorptive capacity, salaries and technical assistance etc.;

- Domestic financing increases by 3 percent of GDP. In 2008 government deposits at the central bank increased by 3 percent of GDP, leading to an increase in foreign currency deposits. In 2009 domestic financing is nil, meaning that there will be no accumulation of government deposits). This means that revenue gains during the previous year will be used to finance expenditure in 2009.

Table 2. National budget in 2008 and 2009 (US\$, million)

	Budget 2008	Budget 2009	Percentage increase from 2008 to 2009	Budget 2009 as percentage of GDP
Total revenue	1,002	1,316	31.3	11.1
Tax revenue	790	1,059	34.0	9.1
Customs	498	585	17.6	4.9
Tax dept.	268	415	54.5	3.5
Non-tax revenue	173	212	22.7	1.5
Capital revenue	38	45	16.6	0.4
Total expenditure	1,385	1,787	29.0	15.8
Current expenditure	870	1,136	30.5	9.5
General administration	119	149	25.5	1.3
Defence and security	133	219	64.1	1.8
Social sector	319	390	22.5	3.3
Health	99	123	24.4	1.0
Education	152	181	19.5	1.5
Economic sector	73	88	21.1	0.7
Agriculture	16	19	16.7	0.2
Rural development	11	16	36.2	0.1
Water resources	6	8	29.2	0.1
Econ. sub and social protection	36	115	224.0	1.0
Capital expenditure	515	649	26.1	5.3
Locally financed	173	213	23.3	1.8
Externally financed	341	415	21.4	3.5
Current balance	93	135	44.9	1.2
Overall balance (excl. Grants)	-383	-470	22.7	-4.8
Financing	383	470	22.7	4.8
Foreign (net)	366	462	26.2	4.7
Domestic (net)	17	8	-52.9	0
Bank financing (net)	29	15	-47.5	0.1

Source: MEF

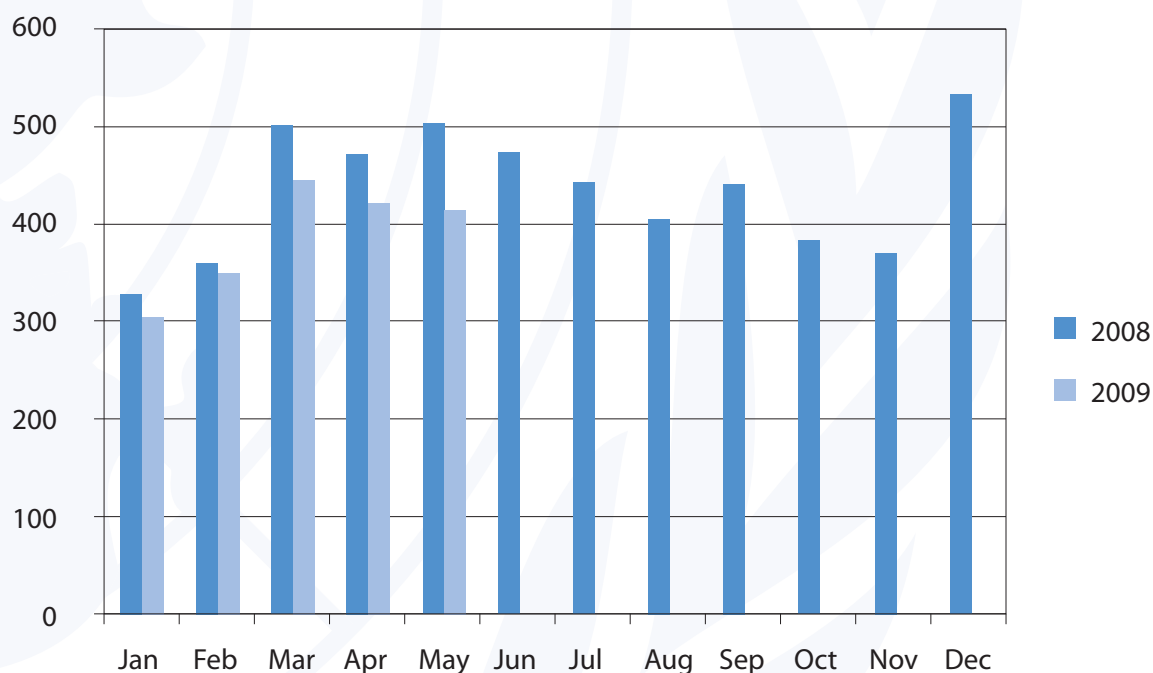
In terms of the impact of the economic downturn, the most important factor is that revenue collection has fallen short of expectations. As Figure 4 illustrates, in the first five months of 2009, revenue reduced by 11 percent, compared to the same five months in 2008. It remains to be seen whether the RGC will be able to meet its target by the end of 2009. The prospects do not look promising due to the reduction of trade and economic activities with no clear indication of when they are likely to pick up.

However, the Cambodian government has significant fiscal space to increase public spending with its savings deposits of approximately US\$600 million, which it has accumulated over the past decade. There is legitimate concern that a substantial increase in government spending could cause depreciation of the riel and could lead to high inflation. The RGC aims to maintain macro-economic balance and stability. Year-on-year inflation did fall to -4 percent in April 2009 and -5.7 percent in May 2009.¹⁶ If public spending is to be increased, it should be cautious and effective. A number of suggestions that may have little or no impact on inflation are provided in Section 5.

The supply of riel accounts for only about 10 percent of the total money supply in Cambodia. Control of the exchange rate is not very difficult under these circumstances. The National Bank of Cambodia (NBC) often buys up excess riel from the market to smooth exchange rate fluctuations. Since government deposits are in both riel and dollars, expenditure can be made in both currencies to ease the potential depreciation pressure on the value of the riel.

NATIONAL REVENUE TRENDS

Figure 4. National revenue trends, January 2008-May 2009 (in billions riel)



Source: MEF

Revenue can be increased by further strengthening tax-collection measures and minimising corruption. Less corruption would not only raise government revenue, but will also improve the investment climate. Corruption was pointed out as the number one constraint to doing business in the World Bank and IFC's *Second Investment Climate Assessment*.¹⁷

¹⁶ "Consumer Price Index". Phnom Penh: National Institute of Statistics/Ministry of Planning, 2008. <http://www.nis.gov.kh/index.php/statistics/cpi-cost-price-index>. July 2009. Web. 29 July 2009.

¹⁷ *Second Investment Climate Assessment: A Better Investment Climate to Sustain Growth in Cambodia*. Phnom Penh: World Bank and International Finance Corporation, 2009.

A significant opportunity to increase government revenue would be through the privatisation of rubber plantations. Cambodia has recently privatised seven state-owned rubber plantations, involving a total of 70,000 hectares of rubber plantations and processing facilities. Much privatisation of rubber plantations has taken place over the last few years with the most recent one completed in early 2009. A private rubber farm could be sold for US\$5,000-10,000 per hectare. If properly privatised, state revenue could be substantial. Since companies taking over the plantations have been granted time to pay the remaining balance over the coming years, ensuring the collection of these dues would be important for the national budget. When considering privatisation, proper safeguards should be in place to avoid the misappropriation of public funds.

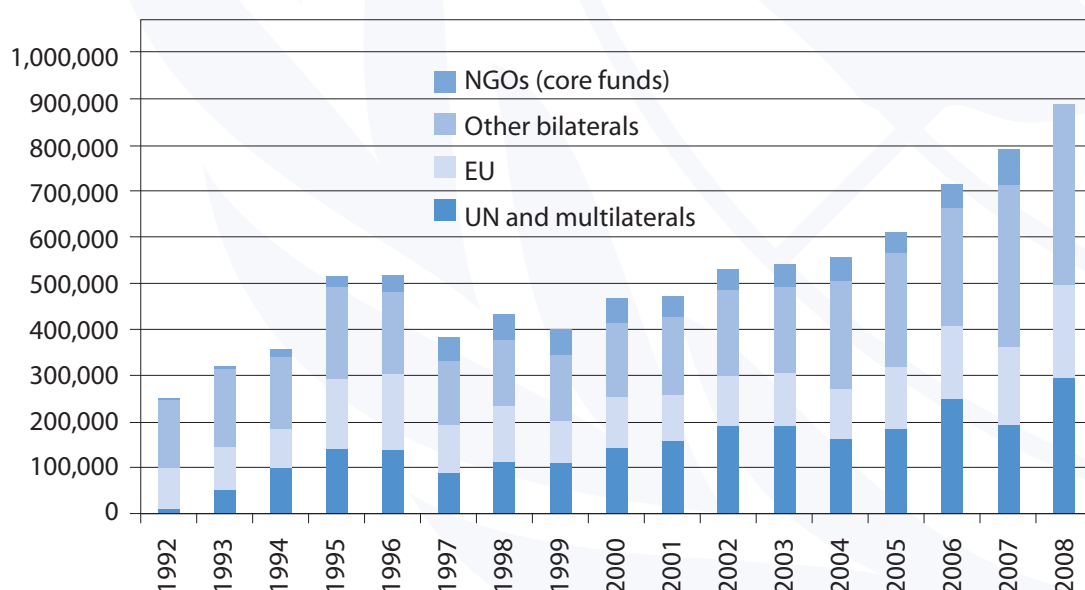
2.3. OFFICIAL DEVELOPMENT ASSISTANCE

After suffering a devastating 30-year civil war, Cambodia held its first general elections in 1993 with the support of the United Nations Transitional Authority in Cambodia (UNTAC). Since then, the country has achieved a remarkable transformation from a war-ravaged to a post-conflict society. Nonetheless, this young democracy is still heavily dependent on foreign aid in the form of ODA, which comprises both grants and loans. Normally, loans account for 20-30 percent of total disbursements and the remainder comes in the form of grants.

Leading development agencies include ADB, the UN including the World Bank, IMF and the Global Fund, EU development partners including the United Kingdom, France, Germany, Sweden, Denmark, Spain, Finland, and Belgium. Bilateral assistance comes mainly from Japan, China, the United States, Australia, the Republic of Korea, Switzerland and New Zealand.¹⁸

The trend for ODA is provided in Figure 5 below.

Figure 5. Disbursements by multilateral and bilateral organisations and the EU, 1992-2008 (US\$, thousands)



Source: CDC

¹⁸ The Cambodia Aid Effectiveness Report 2008. Phnom Penh: Council for the Development of Cambodia-Cambodian Rehabilitation and Development Board, 2008. ii.

The amount of ODA given to Cambodia has increased steadily over the past decade (from US\$250 million in 1992 to nearly US\$900 million in 2008, although it has remained about 8-9 percent of GDP). It dropped sharply in 1997 when the country was mired in political uncertainty. During the last Cambodian Development Coordination Forum (CDCF) in December 2008, development communities pledged a record US\$950 million (or about 10 percent of GDP) in grants and loans to the Kingdom, in the midst of the crisis when ODA was expected to be down sharply. There is, however, a risk of the pledges being different from the actual disbursements. It remains to be seen how development partners will respond to government requests for assistance in the fiscal year 2010. Any reduction of ODA, which has contributed about 40 percent to the national budget, could have serious consequences on the country's development, especially in the social sectors (health and education), economic sectors (agriculture and rural development) and infrastructure (transportation).

ODA flows to Cambodia have been affected by the depreciation of currencies in a number of countries such as the UK, European Union member states, Canada, Australia, and South Korea. The fall in value of donor country currencies since late 2008 means that Cambodia has received less in terms of US dollars, which is the predominant means of payment and unit of accounting in Cambodia. The extent of the depreciation has been about 20-30 percent since October 2008 although the dollar value against a few major currencies has been gradually climbing back since March 2009. This is quite substantial for development projects; it means 20-30 percent less funding in US dollar values.¹⁹

The RGC requested that development partners speed up disbursements of ODA as a way to partly make up for the reduction in private sector investments and revenue and loss of household income during the crisis.²⁰ If ODA project implementation can be accelerated, it will contribute to expanding economic activities and help to mitigate the impact of the economic downturn. Moreover, businesses will generally benefit from improved infrastructure and supporting services built by ODA projects. However, there is concern about absorptive capacity. It takes individual and institutional capacity to be able to execute the ODA projects in accordance with their proper procurement and procedures requirements. Otherwise, there may be more fiduciary risks. Nevertheless, implementation of ODA projects can still be increased in those areas where assistance has already been effective and useful for the poor, as discussed in Section 5 below.

2.4. FOREIGN DIRECT INVESTMENT

Cambodia was relatively insulated from the direct effects on the financial and banking sector that rocked many countries because Cambodia has very little portfolio investment, commercial foreign borrowing or commercial debt. The Cambodian stock market has not yet opened. However, the global financial crisis has indirectly affected Cambodia through FDI. Investors and potential investors found themselves with significantly reduced financial assets as a result of the credit crunch, stock markets plummeting and property markets declining. Declines in FDI and the global tightening of trade financing have impacted Cambodia significantly.

¹⁹ Project implementation is also mostly dollarised in Cambodia.

²⁰ Sen, H.E. Prime Minister Hun. "Keynote Address". Third Cambodia Economic Forum. Raffles Hotel Le Royal, Phnom Penh, 5 February 2009. Address.

According to the Council for the Development of Cambodia (CDC), implemented FDI increased from US\$139 million in 2002 to around US\$800 million in 2008, indicating a large increase in willingness to invest in Cambodia over the past few years. In 2008, almost US\$11 billion was approved or licensed. In general, the actual implementation of FDI is much less than the approved amount due to time lags. For instance, implemented FDI was less than 8 percent of the approved amount in 2008. Due to the global economic downturn, actual FDI in 2009 is forecast by the World Bank to be US\$390 million.

Table 3. Approved FDI, fixed assets (US\$, million)

	2001	2002	2003	2004	2005	2006	2007	2008	2009 (S1*)
Agriculture	6	39	4	12	27	498	136	92	324
Industry	100	57	143	171	913	365	709	725	304
Services	111	143	168	92	155	2,939	1,743	10,003	596
TOTAL	217	240	314	275	1,095	3,802	2,587	10,820	1,223

Source: CDC

*S1= Q1 and Q2

In the first half of 2009 approved FDI decreased to only 11 percent of the total amount approved in the first half of 2008 (see Table 3). Nevertheless, it is not a big change compared to the proceeding years, standing at about 50 percent of total FDI approved for the whole of 2007. What is more, there was a significant increase in licensed FDI in the agriculture sector, while the approvals for the industrial and service sectors fell considerably in the first half of 2009. This is in line with the argument that Cambodia has huge potential to develop agriculture to make up for the contraction in the garment and tourism industries. It should be noted, however, that approved FDI is only indicative of willingness to invest. The time taken to go from the investment proposal stage to actual implementation can be considerable. It may take years for projects worth hundreds of millions of dollars to be completed and that is if investors do not drop out.

The credit crunch in the international market and the loss of assets and capital among wealthy investors and firms around the world has directly resulted in less capital being invested in Cambodia, although it is still regarded as a promising emerging economy. There are issues of flight to safety due to increased risk aversion.

In the last few years, the Republic of Korea and China have been the main investors in Cambodia. The global economic downturn has hit both countries hard and Cambodia has subsequently seen a large reduction or suspension of Korean and Chinese investment projects. A couple of large Korean real estate projects have been suspended, which has been a setback for Cambodia's construction industry. Contractors told inter-viewers in May 2009 that demand for units was only 30 percent of last year's levels. While some contractors continue to complete construction projects, this is not the case for all outstanding projects.

2.5. EXCHANGE RATE ADJUSTMENTS

In the 1990s, when the country was politically and economically unstable, the riel-US dollar exchange rate fluctuated a great deal. Since then, the riel has been relatively stable and over the last decade has fluctuated only slightly, between 3,900-4,250 riel per dollar. The riel depreciated slightly, to over 4,200 riel per dollar in July 2009.

The widespread use of the US dollar in Cambodia makes the country's exports more expensive and less competitive when the US dollar appreciates and more competitive when the US dollar depreciates. The debate on 'de-dollarisation' may gather steam as a direct consequence of the global economic crisis. While matching the value of the riel to the US dollar within a band is good for instilling public confidence in the riel, it can make the riel too strong against other currencies when the dollar is strong against those currencies, as has been the case over the past few months. It is likely that Cambodia's export competitiveness has been eroded by the appreciation of the US dollar against a number of currencies.

The exchange rate between the riel and the US dollar has been relatively stable for 10 years under the managed floating regime. The past few months have seen the riel depreciate somewhat against the US dollar. This is largely due to the reduction in circulation of the US dollar as a result of substantial US dollar earnings reductions through tourism, garment exports and FDI receipts. The government has expressed concern about the depreciation of the riel if it expands public expenditure, which is in riel only. The depreciation of the local currency is likely to cause higher inflation in riel, which is still used widely by rural residents, because a large amount of consumer and producer goods are imported and will be more expensive in riel. This is bound to reduce the purchasing power of the rural population that holds the riel. It may also increase the competitiveness of Cambodian products, especially agricultural commodities because these products are mostly traded in riel.

Table 4. Exchange rate movements (riel vs. US\$, Thai baht and Vietnamese dong)

	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09
Riel per US dollar	4,119	4,118	4,093	4,058	4,105	4,118	4,112	4,104	4,132	4,151
Riel per Thai baht	120	120	117	116	118	116	115	116	120	122
Riel per 100 VN dong	25	25	24	24	24	24	24	23	23	23

Source: NBC

2.6. LOANS AND INDEBTEDNESS

Cambodia's financial sector is very liberal, allowing 100 percent foreign ownership of companies. There is no restriction on the repatriation of profits. Nonetheless, Cambodia's banking and financial sector is still relatively undeveloped and, as a result, was somewhat insulated from the direct adverse impacts of the global financial crisis. None of the 29 commercial banks have reported a liquidity shortage or bankruptcy.²¹ However, the banking system is not completely insulated from the crisis. Slower growth in loans and deposits in most commercial banks has been reported.²² According to a senior representative of a commercial bank, loans and deposits are still growing, but at a slower rate.

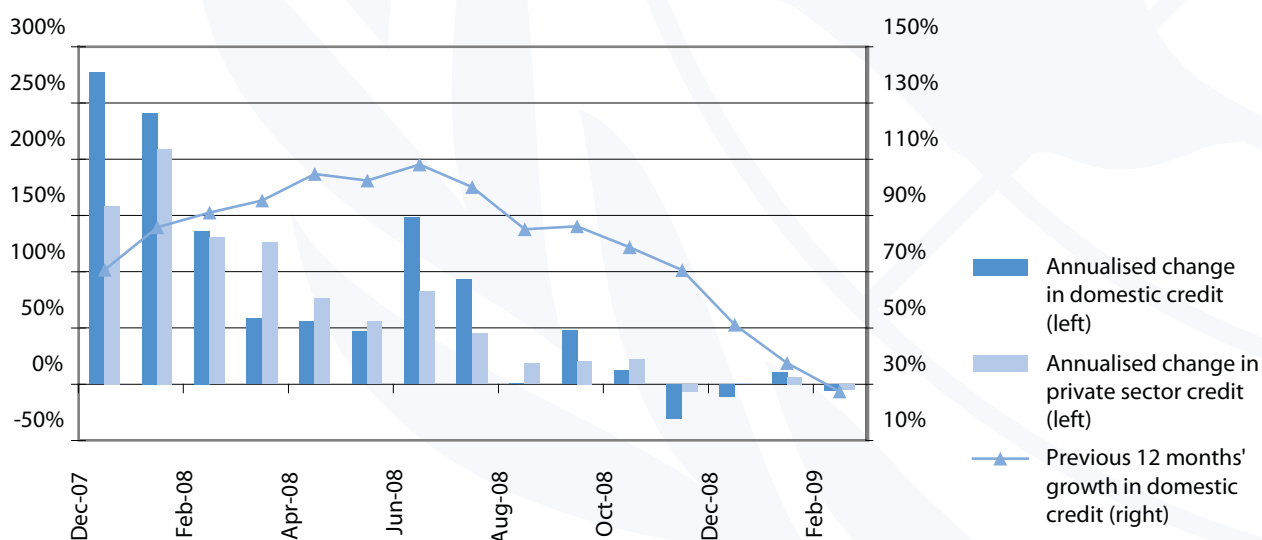
²¹ The recent openings of two new banks brought the total number of banks to 29.

²² Sovann, Nguon. "Bank deposits and loans drop". Phnom Penh Post, 27 April 2009: 15.

During the boom in 2007 and the first half of 2008, private sector credit increased well above 100 percent from the previous year. This was fuelled by the property market boom and confidence in, and the availability of, the banking system. Many used property or land as collateral to borrow money. Since the price of property and land had been rising significantly, people could borrow more easily. Credit to the private sector doubled in the first half of 2008. Micro-finance institutions (MFIs) were also lending much more than ever before. As a result of the unfavourable global and domestic economic situations, conditions for loans have since tightened.²³ After growing so much in the preceding year, credit started to slow down in the last quarter of 2008 as a result of the impact of the global economic downturn on Cambodia (see Figure 6). In another sign that the country's banking system is under stress, the NBC said its latest supervision report showed non-performing loans (NPLs) rising from US\$58 million in June 2008 to almost US\$88 million by the end of the year. That accounted for 3.68 percent of the loan portfolios of all commercial banks, which stood at close to US\$2.4 billion by the end of 2008. In the first half of 2009, MFIs reported increasing NPLs and numbers of borrowers requesting repayment deferrals. This is a sign of the negative impact of the economic downturn on the banking sector.

The high rate of households with outstanding loans was one of the most striking findings of a July survey by the Cambodian Economic Association of 1,070 households randomly selected in 15 villages representing different characteristics of agricultural households. Within the entire sample, 70 percent of the households reported having outstanding loans from informal moneylenders, ACLEDA, MFIs and relatives. Most of the loans were taken in 2009. The inability to repay loans is one of the major concerns reported by those households. Compared to a year ago, only 60 percent of the households in the same communities reported that they had outstanding loans. Increased indebtedness is a strong indicator of the negative impact of the economic downturn.²⁴

Figure 6. Growth in domestic and private sector credit



Source: NBC

²³ Nelmes, John. "Global Crisis: Impact, Outlook and Policy Options for Cambodia." Cambodia Outlook Conference. Phnom Penh Hotel, Phnom Penh. 12 March 2009. Presentation.

²⁴ The Impact of the Global Economic Downturn on Communities in Cambodia: Special Study Report of the Cambodian Economic Association. Phnom Penh: Cambodian Economic Association, 2009 (forthcoming).

Money in circulation and deposits in banks stopped growing in May 2008 following the introduction of the NBC policy to increase the reserve ratio from 8 to 16 percent. This was done in an attempt to curb rising inflation, which had partly been caused by external factors (the increase of oil, fertiliser and food prices which essentially drove up inflation). A slight decline in total liquidity was apparent in September 2008, followed by a drop over the next two months before remaining constant in December. The NBC decreased the reserve ratio from 16 to 12 percent to make more loans available, especially for the agricultural sector. Many bankers suggested lowering the reserve requirement back to 8 percent.

BOX 1. SPENDING MULTIPLIERS

The economic downturn appears to have eroded confidence among consumers and firms. They are tending to save more of their falling incomes. This has resulted in decreasing spending multipliers as there is a shift from consumption to saving. During boom times, people spend more. Conversely, during periods of contraction, investors and households spend less, meaning that less money changes hands, leading to job losses or reductions in income.

A number of hotels in Siem Reap have been closed and many are running with very low occupancy rates due to both the economic downturn and the fear of Influenza A(H1N1). A massage shop reported that they no longer saw the Korean customers who used to visit regularly. The shop owner indicated that she believed business was slower as a result of the economic crisis. The shop was making only one-fifth of the income it had made a year ago.

A nearby restaurant owner independently reported drastic revenue reduction, to the point that it is threatening the restaurant's survival. They no longer had a large number of office workers regularly coming for lunch.

The souvenir shops had very few customers and some were already closed. The same was happening to *tuk-tuk* and *motodop* drivers, who reported spending less money because they were now earning less. This has affected the sellers of fruits and the owners of mobile food stalls, most of which are run by the poor. They reported that they were only selling one-fourth of what they sold a year ago. Spending multipliers became very small during this low time in Siem Reap.

Elsewhere, interviews with households affected by the crisis found that most of them had reduced expenditures, especially on non-essential items like eating out. Restaurants and other sellers of cooked food reported they were earning less than 50 percent of what they earned one year ago. Raw food sellers also reported making only 50 percent of the income they had earned a year ago.

Source: UNDP interviews, 15 May 2009

2.7. BALANCE OF PAYMENTS

The balance of payments is the best tool to indicate the inflow and outflow of capital in an economy. Final estimates of the balance of payments require a considerable amount of time because they entail final trade, investment and capital and income transfer data. This review of the recent development of balance of payments relies on projections based on preliminary data. The Economic Institute of Cambodia (EIC) has published its projections for 2007, 2008 and 2009. As presented in Table 5, these projections indicate

that the overall balance changed from being substantially positive in the past two years to negative in 2008 and 2009, when the global economic crisis hit Cambodia. The trade deficit was at its worst in 2008 as imports of goods increased by US\$1,000 million. Exports increased by only US\$300 million, which created a current account²⁵ deficit of US\$748 million.

The overall balance of payments in 2009 is projected to be a US\$118 million deficit, a fall from US\$75 million in 2008. The national reserve accumulated from the overall balance surplus so far stands at around US\$2,000 million and is, therefore, still in a relatively good position. This equals about three months of imports, which is not that large an amount. Of the total reserve, about US\$1,500 million belongs to the state, some of which is in the form of overseas investments, while about US\$500 billion is in the form of private sector bank deposits.²⁶ According to the projection in Table 5, the trade deficit will decrease in 2009 compared to the previous two years since imports are estimated to decline sharply, while exports are projected to remain constant. International reserves will shrink by more than US\$100 million in 2009, which is not a favourable development. The actual outcome could be even worse because of negative trends in garment exports and tourism revenues in 2009.

Table 5. Balance of payments (US\$, million)

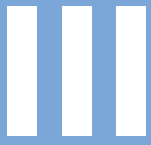
Item	2006 projection	2007 projection	2008 projection	2009 projection
Exports of goods	3,693	4,088	4,708	4,737
Imports of goods	4,727	5,419	6,456	5,969
Trade balance	-1,034	-1,331	-1,748	-1,232
Agriculture	401	578	851	989
Textiles and garments	1,430	1,566	1,602	1,446
Oil and gas	-1,123	-1,306	-1,555	-805
Other goods	-1,741	-2,168	-2,646	-2,862
Balance of	516	643	617	633
Transportation	-270	-300	-373	-411
Travel (tourism)	841	1,012	1,113	1,167
Others	-56	-69	-124	-122
Balance of incomes	-319	-385	-468	-526
Balance of current transfer and capital account	790	855	851	863
Private transfer	315	377	365	367
Government transfers	475	478	486	496
Current account	-47	-218	-748	-262
Financial accounts	282	661	673	144
Official loans	118	184	220	184
Foreign direct investment	475	866	806	362
Others (net)	-311	-51	-52	-52
Overall balance	235	444	-75	-118

Source: NBC and EIC model projections (From Economics Today, Special Issue July 2009, Volume 2, Number 42: 57)

²⁵ "[A] statement of a country's trade in goods and services with the rest of the world over a given period of time." (Pass, Christopher, Bryan Lowes, Leslie Davis, Sidney J. Kronish. The Harper Collins Dictionary of Economics. New York: Harper Perennial, 1991. 110).

²⁶ Interview with H.E. Dr. Hang Chuon Naron, Secretary General of the Ministry of Economy and Finance and Permanent Vice Chairman of the Supreme National Economic Council (SNEC), 6 June 2009.





SECTORAL IMPACT



This section provides an outline of the direct channels of transmission of the economic downturn on the key sectors of the Cambodian economy. It looks at garment exports, tourism revenues, property and construction and agriculture. Discussion of the impact on people engaged in these sectors follows in section 4.

3.1. GARMENT EXPORTS

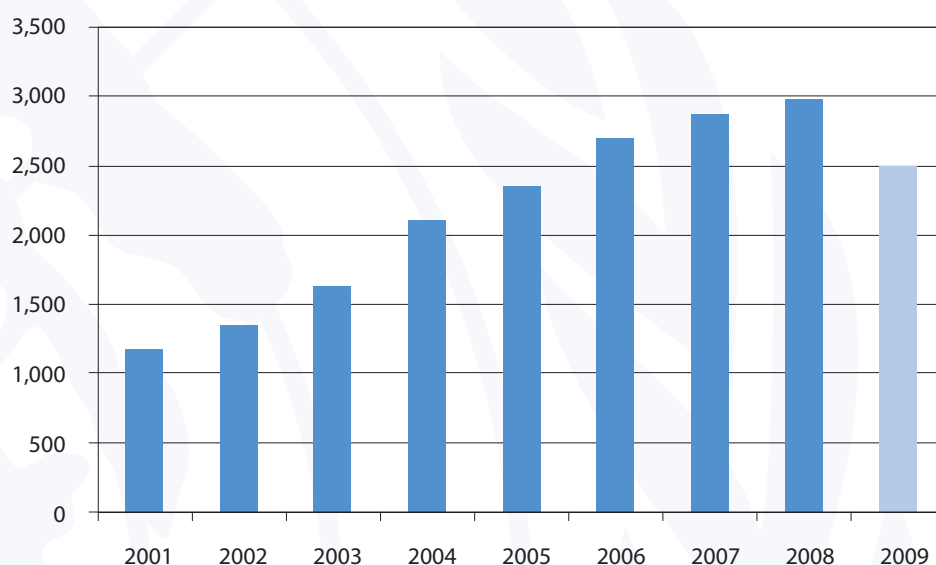
Cambodia's exports are overwhelmingly dominated by garments, which accounted for 75 percent of exports in 2002 and 65 percent in 2008. The global economic downturn has resulted in a sharp reduction in demand for goods and services in general. According to data from the MoC, garment exports in the first four months of 2009 dropped by 27 percent compared to the same period last year.²⁷ A small number of factories have been spared because they have solid relationships with buyers in Europe, according to a representative of the Garment Manufacturers Association in Cambodia (GMAC). This downward trend is likely to continue in the second half of the year with most garment factories reportedly running at only 60-70 percent of capacity, and cutting down on subcontracts to smaller factories. GMAC reported in an interview with UNDP that orders are down by almost 40 percent and, more worryingly, that there are orders for only a few more months, in contrast to previous years when orders normally lasted for four to six months. As 90 percent of garment products are exported to US and EU markets, economic recovery in these countries directly impacts the recovery of Cambodia's garment sector. Cambodia's competitiveness in the industry matters. Bangladesh and Viet Nam exported more garments than last year, while Cambodian exports declined, suggesting a real need to improve competitiveness in this sector.

Cambodia's garment exports totalled US\$2.9 billion in 2008. Compared to 2007 exports of US\$2.8 billion, exports still grew, but at a much lower rate than in the previous 10 years, despite being hit by the early impact of reduced demand in the last quarter of 2008 (see Figure 7). However, as evidenced by the lower demand for garment exports for the first four months of 2009, a serious contraction in garment exports is forecast for the year. The total value of garment exports for the first four months of 2009, as outlined by the MoC, was US\$655 million. If this trend continues, the total value for 2009 is estimated to be US\$2,000 million, or a more optimistic forecast could be US\$2,500 million. This is still about 16 percent less than was seen over the last three years, and not the 5 percent projected by many institutions. This study projects a decline of between 15 and 20 percent.²⁸

²⁷ Figures for May and June have not been finalised, but reportedly do not show improvement.

²⁸ Sophal, Chun. "Garment exports plummet 18 pc over first half of year". Phnom Penh Post, 17 August 2009: 13, reported that the latest data from the Ministry of Commerce indicated that the garment exports declined 15 percent between the first half of 2009 and the first half of 2008. The President of the Garment Manufacturers Association of Cambodia was quoted as saying he expected a 40 percent drop for the whole of 2009 compared to 2008.

Figure 7. Cambodia's garment exports, 2001-2008 (US\$, million)



Note: Data for 2009 is forecast based on export value of US\$655 million in the first four months of 2009.

Source: MoC

Table 6 provides details of monthly garment exports for the same four months in each of the last three years. Comparing the same months in 2007, 2008 and 2009 indicates a sharp decline in garment exports during January, February, March and April 2009. Initial data for May and June 2009 do not show improvement. Unless the trend is reversed in the second half of 2009, the decline in garment exports is likely to exceed 15 percent compared to 2008. This will have a bearing on economic growth because the garment sector comprises 15 percent of GDP.

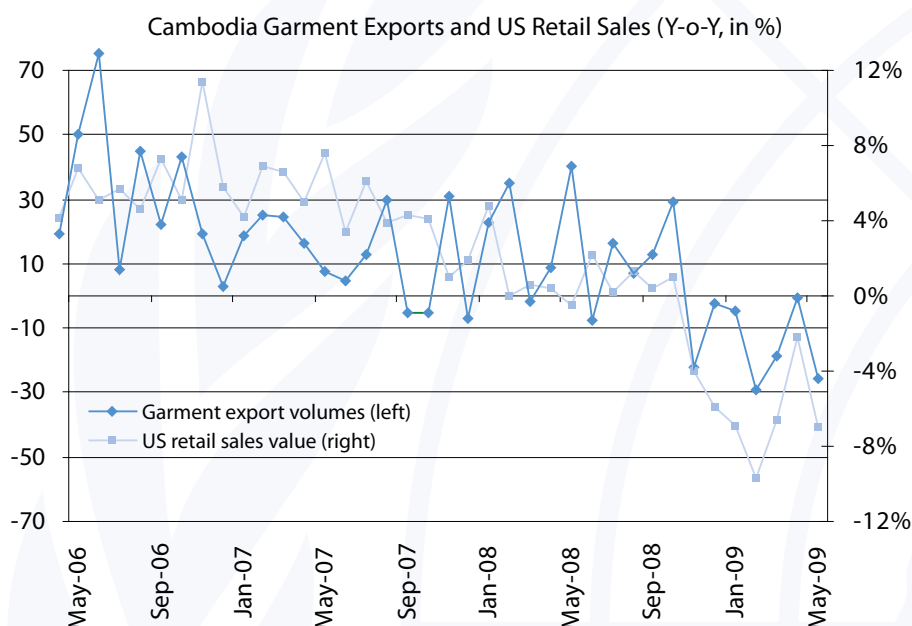
Table 6. Monthly garment exports in the first four months from 2007 to 2009 (US\$, million)

	January			February			March			April		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
US	163.7	166.0	118.8	163.1	173.4	127.4	180.2	192.6	102.4	126.9	112.4	67.8
EU	37.9	41.3	38.6	31.9	38.4	34.9	28.1	50.7	35.8	31.7	29.2	33.4
Canada	10.4	16.6	13.1	16.5	15.5	17.7	8.2	16.5	12.9	6.2	8.5	8.3
Other	6.8	8.5	12.5	5.1	9.2	10.3	4.1	8.1	13.7	2.7	5.9	7.5
Total	218.7	232.4	183.0	216.7	236.5	190.4	220.6	267.9	164.7	167.5	156.0	117.0
Change		6 %	-21%		9%	-19%		21%	-39%		-7%	-25%

Source: MoC

Figure 8 illustrates the close association between Cambodia's garment exports and US retail sales. This broadly suggests that the garment industry's recovery is highly dependent on the recovery of the US. However, this is not entirely the case. As revealed in Table 7 below, a number of countries, which are Cambodia's close rivals have done even better during this period, even though the US imported 12.04 percent less garments.

Figure 8. Relationship between Cambodia's garment exports and US retail sales



Source: Hang, Saing Chan. "Impacts of global economic crisis on garment workers and remittances in Cambodia". Public Forum on the Impact of the Global Economic Downturn and the Need for Policy Responses. Cambodia-Japan Cooperation Center. 14 July 2009. Presentation.

Data from the U.S. Department of Commerce shows that Cambodia's garment exports to the US dropped by as much as 22 percent in the first five months of 2009, compared to the same period in 2008. This is largely in line with the data from the Cambodian MoC. In the same period, US garment imports fell by 12.04 percent, meaning Cambodia experienced a worse decline in exports than its competitors. Cambodia's direct competitors, such as China, Viet Nam and Bangladesh, managed to increase their exports to the US by 3.23 percent, 1.47 percent and 9.51 percent, respectively. This indicates an erosion of Cambodia's competitiveness and suggests the need for urgent measures to revive this industry. Policy recommendations are provided in Section 5.

Table 7. US garment imports by country in 2007, 2008 and early 2009

Country	Value, (US\$, million)		% change	Value, (US\$, million)		% change
	2007	2008		Jan-May 2008	Jan-May 2009	
WORLD	73,922	71,569	-3.29%	26,994	23,743	-12.04%
China	22,745	22,923	0.77%	7,259	7,494	3.23%
ASEAN	15,204	15,520	2.03%	6,185	5,561	-10.08%
Viet Nam	4,358	5,223	16.55%	1,905	1,933	1.47%
Indonesia	3,981	4,028	1.17%	1,677	1,648	-1.73%
Cambodia	2,425	2,376	-2.06%	964	752	-22.00%
India	3,170	3,073	-3.14%	1,501	1,371	-8.66%
Bangladesh	3,103	3,442	9.83%	1,345	1,473	9.51%
Sri Lanka	1,573	1,467	-7.25%	603	546	-9.45%
Pakistan	1,498	1,489	-0.60%	559	481	-13.95%

Source: U.S. Department of Commerce, International Trade Administration, Office of Textiles and Apparel (<http://otexa.ita.doc.gov/MSRCTRY.htm>). Last updated 10 July 2009, accessed 20 July 2009.

3.2. TOURISM

Along with garments, tourism has played a vital role in supporting Cambodia's economic growth and poverty reduction efforts. Using the strict definition of tourism, the tourism sector contributes around 13 percent of GDP, earning US\$1,595 million in 2008 (see Table 8). However, its contribution may be closer to 20 percent when a looser definition is used and related activities are taken into account.²⁹ The contraction of this sector has a significant bearing on the whole chain of the economy, ranging from five-star hotels to local restaurants and taxi divers.

The tourism sector in Cambodia has developed quite rapidly due to the abundance of ancient temples such as Angkor Wat. This is also a result of Cambodia initially starting at a low tourism base. In 1992 the country received only 20,000 tourists. By 2007, the number of foreign tourists had topped the 2 million mark (see Figure 9). However, this "represent[s] only about 3 percent of the total volume of international tourist flows in ASEAN countries."³⁰

Table 8. Significance of tourism in the Cambodian economy

	2002	2003	2004	2005	2006	2007	2008
Tourist arrivals (thousands)	787	701	1,055	1,422	1,700	2,015	2,126
Tourism receipts (in millions US\$) ³¹	454	389	578	832	1,049	1,400	1,595
As percentage of GDP	10.6	8.5	11.5	13.4	13.3	13.1	13.2
Average receipt per tourist (in US\$)	577	555	572	591	566	563	750

Source: MoT

The number of tourist arrivals continued to grow in 2008, albeit at a slower pace of 5.19 percent. However, breaking the year down by quarters, first, second and third quarter tourist arrivals increased 14.5 percent, 6.5 percent, and 4 percent respectively, indicating a gradual slowdown. For the first time since 2003, tourist arrivals dropped by 5.26 percent in the fourth quarter of 2008.³² This number is not alarming, but it does mark the first decline in many years and undoubtedly causes concern among stakeholders.

The downward trend continued well into 2009. The number of foreign tourists visiting the country dropped slightly year-on-year by about 2.28 percent in the first five months of 2009.³³ However, these arrival numbers are still much higher than during the low period experienced in mid-2008. According to statistics compiled by the Ministry of Tourism (MoT), tourist sources have changed. Since the global financial crisis, Cambodia has received fewer tourists from Korea and Japan, as well as other high-income countries, but more from lower income countries such as Viet Nam, China and Lao PDR. This has implications for Cambodia's tourism receipts. For example, tourists from Viet Nam generally travel by bus, which is less costly and they spend less money in Cambodia. The adverse effects of the global economic crisis, political uncertainty in Thailand and the outbreak of Influenza A(H1N1), are likely to result in a continued downward trend.

²⁹ Including business and other purposes.

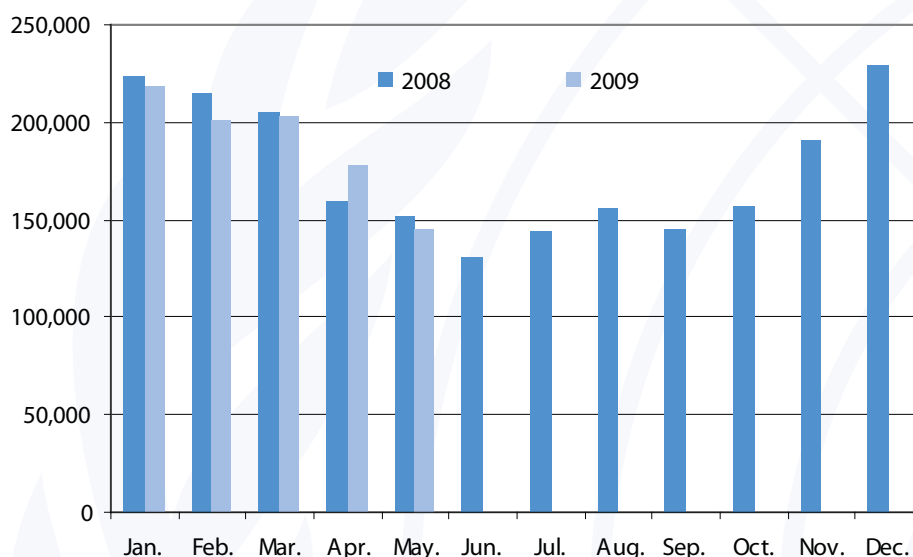
³⁰ Cambodia Country Competitiveness: Driving Economic Growth and Poverty Reduction (Discussion Paper No. 7). Phnom Penh: UNDP, 2009, 43.

³¹ Including business and other purposes.

³² Ministry of Tourism

³³ Ministry of Tourism

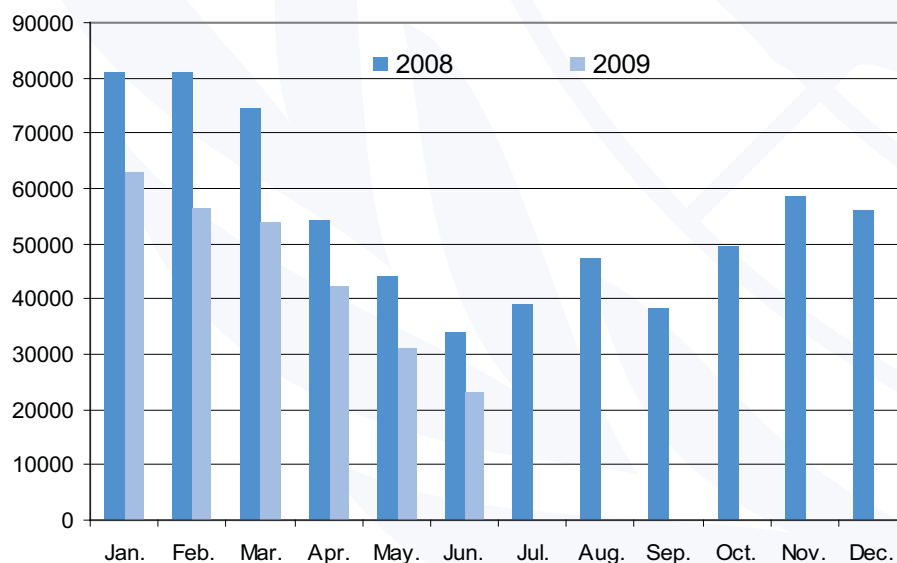
Figure 9. Recent trends in tourist arrivals in Cambodia, January 2008-June 2009



Source: Tourism Statistical Report May 2009, MoT

The impact of the tourism decline is most serious in Siem Reap, the central attraction for foreign visitors to Cambodia. During fieldwork in May 2009, a number of interviewees stated that businesses in the provincial town were operating at less than 40 percent of what they saw a year ago. Tourist arrivals in Siem Reap in the first six months of 2009 declined substantially compared with the same months in 2008 (see Figure 10). This has seriously affected the province's economy. It should be noted that the reason for the decrease is partly seasonal, as Figure 10 suggests. For resilient businesses, this decline is less serious, but for more vulnerable groups such as unskilled workers and street vendors, the impact is more serious.

Figure 10. Recent trends in tourist arrivals at Siem Reap airport, January 2008-June 2009



Source: Siem Reap Airport

3.3. AGRICULTURE

Besides garments, Cambodia exports a number of agricultural products, but the majority are informal and are not recorded. Exports of key products such as rice, rubber and fish are estimated or recorded in part, but exports of products such as cassava, soybean, maize, mung beans, sesame seeds, and cashew nuts are poorly recorded (see Table 9). Agricultural exports are expected to increase in volume in 2009. However, nominal export receipts are likely to be lower due to falling prices resulting from the global economic downturn. The RGC has pinned its hopes on agriculture to lead the country through the crisis. To this end, the government has paid extra attention to agriculture by amending the 2009 Budget Law to allow for the addition of US\$18 million to loan to rice millers through the Rural Development Bank. It is hoped that this will expand capacity to purchase paddy and process it for export, an area that requires hundreds of millions of dollars.

Depending on levels of rainfall, a good harvest would mean a surplus of rice for export. With land for rubber plantations expanding quickly, the country exported 40,000 tonnes of dry rubber in 2008 and is expected to export 50,000 tonnes in 2009. Increased rice and rubber exports are unlikely to compensate for the decline in garment exports if the trend in the garment sector continues for the rest of the year. A 15-20 percent decline in garment exports would mean a loss of nearly US\$500-600 million, while an expected 5 percent increase in rice and rubber exports would be a gain of only US\$30 million, (see Table 9). In terms of value-added, rubber exports are relatively more significant although nowhere near the value of garment exports.

Table 9. Cambodia's exports, 2002-2007

	2002	2003	2004	2005	2006	2007
Total exports (in millions US\$)	1,770	2,087	2,589	2,910	3,694	4,089
Garment exports (in million US\$, as percent of total exports)	1,343 (75.9%)	1,609 (77.1%)	1,982 (76.6%)	2,190 (75.3%)	2,651 (71.8%)	2,866 (70.1%)
Log and sawn timber (US\$, million)	38	20	16	16	18	21
Fish (US\$, million)	73	76	69	76	90	105
Rubber (US\$, million)	63	98	115	119	175	157
Rice (US\$, million)	28	94	114	177	332	411

Source: IMF and MoC

Table 10 and Figure 11 show that the prices of major agricultural commodities declined substantially in early 2009 compared to May and July 2008 when they peaked. Although recent prices are not much lower than the pre-boom period, producers incurred higher production costs because oil prices were very high in the period up to July 2008. This substantially increased the costs of machinery, commercial fertiliser, other inputs and transportation. Due to high food prices in 2008, labour costs increased by around 50 percent. Many producers either made a loss or made very little profit from farming in the past year. As prices and revenues declined in 2009, wages dropped about 10 percent, reflecting a level of downward rigidity.³⁴

³⁴ In economics, downward rigidity refers to the fact that it is easier to increase wages when inflation is rising highly than decrease wages when inflation is declining.

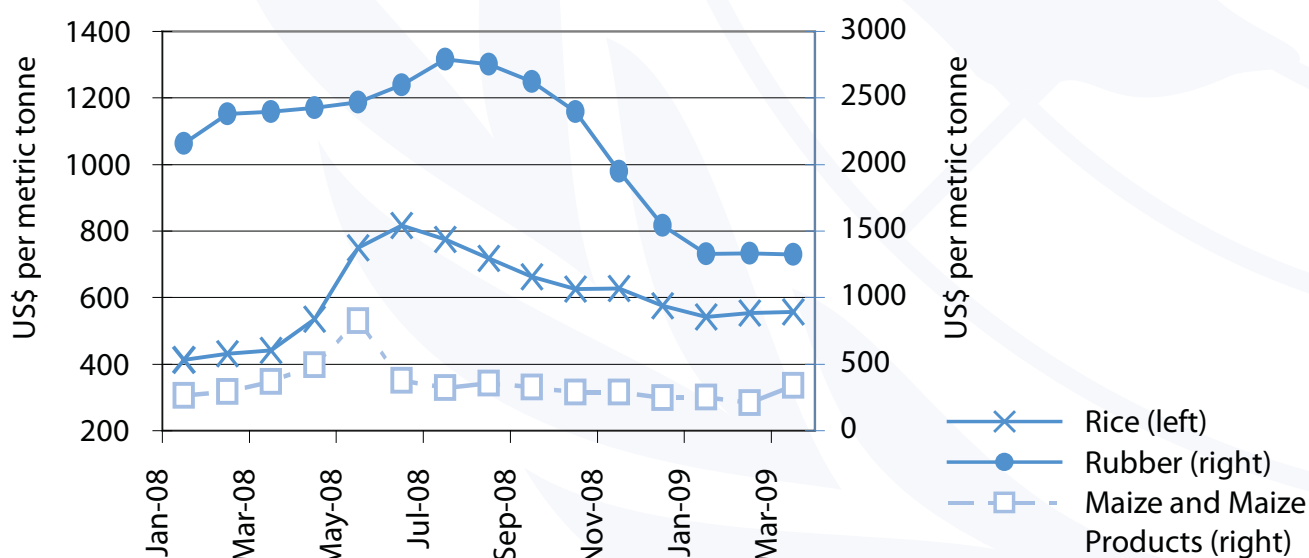
The price of dried rubber peaked at a record US\$3,250 per tonne in August 2008, according to a rubber exporter. The average price that month was nearly US\$3,000 per tonne, compared with around US\$2,000 per tonne the previous year. The increase in the price of rubber was a result of both the global economic boom, which increased demand for cars and tyres, and rising oil prices that raised the price of synthetic rubber.³⁵ China, a large rubber consumer for both domestic needs and tyre exports, demanded large amounts of rubber from Southeast Asia.

Table 10. Change in price of key agricultural products (riel/kg, except for rubber)

Retail Sale*	06 July 2008	06 July 2009	% change
Rice	3,200	2,500	-22
Fish	14,500	13,000	-10
Beef	24,500	22,300	-9
Pork	17,500	15,300	-13
Chicken	15,500	15,000	-3
Wholesale**	09 May 2008	09 May 2009	% change
Black pepper (Kampong Cham)	13,750	7,267	-47
Cashew nuts (Kampong Cham)	3,142	2,971	-5
Cassava (dried chips, Kampong Cham)	725	413	-43
Maize (Phnom Penh)	1,248	1,083	-13
Paddy (Kngork Pong, Kampong Cham)	1,600	950	-41
Soybeans (Kampong Cham)	3,123	2,242	-28
Rubber (Kampong Cham)*** (US\$/ton)	2,560	1,440	-44

Sources: * EIC Survey in Phnom Penh markets
 ** MAFF
 *** Interview

Figure 11: Price trends of rice, rubber and maize in Thailand (a market for Cambodian agricultural products)



Source: Customs Department of Thailand

³⁵ A collaborative study on the production and trade of rubber and cassava in the Greater Mekong Subregion countries was conducted in 2007 and 2008, as part of the Development Analysis Network, coordinated by CDRI. The findings are currently being published.

The rapid rise in the price of rubber made rubber production highly profitable and attracted much interest in rubber farm investments in 2008. However, by the end of 2008, following the collapse of the automobile industry and the reduction of oil and synthetic rubber prices, the price of natural rubber in Cambodia plummeted from the peak of above US\$3,000 per tonne around mid-2008 to below US\$900 per tonne in late 2009. After staying low for a few months, it has gradually increased to around US\$1,400 per tonne in the second quarter of 2009, providing a small margin of profit to rubber farmers. Cassava has experienced a similar trend. To some extent, the price of rice has also behaved in a similar manner. The impact of these price changes on farmers is discussed in Section 4.

3.4. PROPERTY MARKET AND CONSTRUCTION SECTOR

Construction is one of the hardest hit sectors due to its strong relationship with FDI. As discussed above, both current and potential investors from a number of developed countries have been directly affected by the crisis, which substantially reduced their capital base, limiting their prospects to invest in emerging markets such as Cambodia. As a result, a number of large construction projects have been suspended. The construction companies interviewed reported a drastic reduction in the number of contracts they have for future work. Kang et al (2009)³⁶ estimated that FDI constituted about 75 percent of the capital financing of most construction work and that 30 percent of construction jobs have evaporated since January 2009.

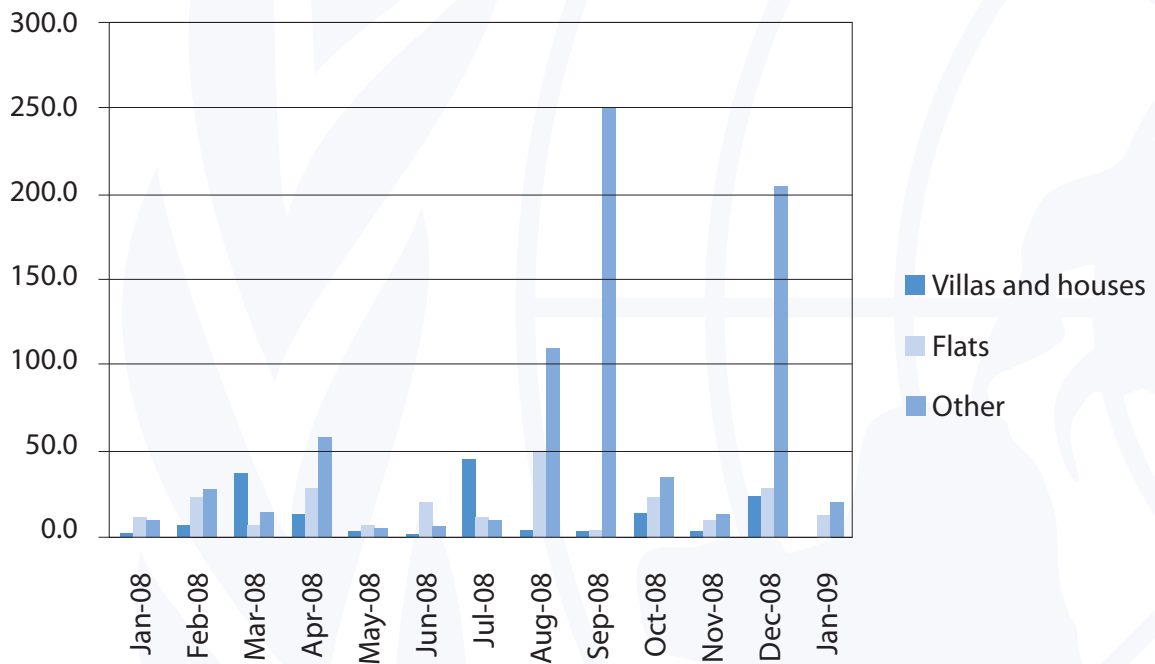
According to construction companies, many workers were still needed to complete old and existing projects until as recently as early 2009. However, after these projects are complete many workers may become unemployed due to the fact that construction companies are now booked for only 30-50 percent of the amount of work they had last year. In certain months, some labourers are less affected by being temporarily out of work as it allows them to give priority to preparing rice land and transplanting paddy in the early wet season (May-October). Normally, after transplanting paddy, they are idle until the harvest comes four or five months later (in November-December) and they tend to come to Phnom Penh or other urban areas for seasonal employment in July-October. If the prospects for construction and job creation are not improved, many seasonal labourers will find it difficult to support their households. It is important that unemployment is regularly monitored in the months to come.

The economic crisis has impacted real estate prices. The price of land in Phnom Penh is reported to have decreased by 50 percent on average compared to a year ago. House prices and rental prices also declined substantially, according to a leading real estate company, Bonna Realty Group. This has eroded the assets and incomes of households and businesses that could otherwise be used to expand businesses or investment, fuelling economic growth. The decline of the Cambodian property market is similar to that in the US or other markets in that it came after a speculative boom in 2006 and 2007.

³⁶ Kang, et al. "Rapid assessment of the impacts of the economic crisis on Cambodian households: component 2-informal risk management and safety net practices" (working title). Phnom Penh: CDRI, 2009 (forthcoming).

It is interesting to note that approvals for construction in Phnom Penh were generally high in value between August 2008 and January 2009 (see Figure 12). This is due to the construction of projects other than villas, houses and flats. The new category, called 'other', includes large real estate projects such as condominiums, apartments and hotels. This is somewhat like approved FDI. In fact, it is that part of FDI that seeks to build large tourism projects and factories. According to property developers, it takes around six months to get construction approvals. Applications may have been lodged during the boom time, but approvals came through months later. Actual implementation may then be halted.

Figure 12: Approval of construction projects



Source: Municipality of Phnom Penh



IV IMPACT ON PEOPLE



This section attempts to examine the impact of the global economic downturn on different groups of people, especially the poor, the near poor and those vulnerable to shocks. The first wave of impact refers to those who are directly hit, such as workers in industries that are exposed to or dependent on external markets. This, to a considerable extent, is also the case for farmers producing for export.

The second wave of impact affects people who are dependent on those individuals directly and negatively impacted, and those households that will have to provide support to laid-off workers and returned migrants. This section discusses how the impact is affecting different groups of people at different stages.

Profile of vulnerable groups in Cambodia

Groups	Number/Percentage
Youth entering workforce	250,000/1.7% of population ³⁷
Children under 5	1.3 million/9.7% of population (CSES 2006-7)
Children who die from preventable diseases	30,000 (0.2% of population)
Those working in the informal economy	10.5 million 74.6% (CSES 2006-7)
Landless	21.1% of rural households CDRI ³⁸
Farmers with less than 0.5 hectares	23.4% of rural households (CDRI)
Disabled	854,000/6.1% (CSES 2006-7)
Ethnic minorities	308,000/2.2% (CSES 2006-7)
Victims of HIV/Aids	1.32 per 1000 (CSES 2006-7)
Food insecure	1.7 million (CDRI 2008)/12.1%
Laid off garment workers	63,000 since September 2008 (Ministry of Commerce) (14% of garment workforce)
Sex workers	32,000 (direct and indirect) 2006 MoH
Garment workers	301,000 (Minister of Commerce)
Migrants abroad	348,000 2.5% of population (World Bank Migration Factbook – exact figures difficult to estimate due to informal nature of migration)

4.1. FIRST ORDER IMPACT VICTIMS

First order impact victims include garment workers, construction workers, tourism industry workers, farmers, and migrant workers. The discussion that follows is based on both government data for the whole industry and the insights generated from fieldwork and interviews during this study as well as other relevant surveys.

³⁷ Youth aged 15–24 represented 22 per cent of the population in 2004. Source: ILO Policy Brief on Youth Employment in Cambodia http://www.ilo.org/wcmsp5/groups/public/---asia/---ro_bangkok/documents/publication/wcms_bk_pb_141_en.pdf

³⁸ National survey of 2,235 households in June 2008 conducted by CDRI.

4.1.1. GARMENT WORKERS

According to the MoC, the total number of garment industry workers fell from 352,955, mostly female, full-time workers in September 2008 to 290,439 in May 2009. This means as many as 63,000 workers, or 18 percent of the total workforce, have been laid-off in the past year. Moreover, many others have been temporarily suspended or can no longer work overtime. Since the majority of the garment industry workforce is female, the impact of the global economic downturn has been overwhelmingly felt by women. During this period, 70 factories were reported closed, although 20 have opened, resulting in a net closure of 50 factories. The corresponding loss of salaries is estimated at US\$6.2 million per month. This does not include income reductions for a number of those still working. A recent small sample survey conducted by the Cambodia Development Resource Institute (CDRI) found that earnings of those still in the workforce dropped by 18 percent in real terms between May 2008 and May 2009 and remittances to their families in rural areas declined by 6 percent.³⁹ A small number of factories closed and reopened to take advantage of tax holidays. This may make it more difficult to accurately calculate the number of laid-off workers.

Substantial job losses in the garment industry have alarmed both policy-makers and stakeholders. The Government has responded with a fund allocation of US\$7.5 million to retrain laid-off workers, including garment workers, for one to four months, and to provide micro-credit to establish small businesses following the training. The government is also encouraging greater investment in the agricultural sector to facilitate the absorption of workers into rural communities. However, not all laid-off workers are returning to rural areas. Many are remaining in Phnom Penh to look for different jobs or are staying with their spouses or partners. No studies or surveys have been able to state exactly how many laid-off workers returned to rural areas, how many have found other types of employment, and how many have stayed in the city to look for jobs. A tracking study has been planned by UNDP and the International Labour Organization (ILO) to answer these questions, among others.

BOX 2: LAID-OFF GARMENT WORKERS

Select interviews were conducted with laid-off workers who returned to rural areas and those who remained in the city. A total of 33 laid-off workers were located in Phnom Penh, Kandal, Kampong Speu, Kampong Thom, Kampong Cham and Prey Veng to gain an understanding of the spectrum of issues they have encountered. All of the interviewees were female, reflecting the overwhelming majority of women in the garment workforce. They were, on average, 25-years-old, having completed 6.2 years of school on average. Despite their youth, they each supported an average of four dependents. They had all been unemployed for one to seven months, having been employed in the sector for 2.9 years on average. Earnings varied from US\$60-120 per month. They were able to save an average of US\$34.40 each month to support their families. This is consistent with a larger quarterly survey conducted in May 2009 by CDRI.

Va Ratha:

Va Ratha, a 26-year-old married woman from Speu village, Cheyo commune, Chamkar Leu district, Kampong Cham province, worked in Kandal for four years, but her job ended in March 2009. She returned home to stay with her husband because she could not find a job at another factory.

⁴⁰ Hang, Saing Chan. "Impacts of global economic crisis on garment workers and remittances in Cambodia". Public Forum on the Impact of the Global Economic Downturn and the Need for Policy Responses. Cambodia-Japan Cooperation Center. 14 July 2009. Presentation.

Even when Ratha made US\$120 working in Kandal province, she could not save any money because her food, accommodation and other personal expenses cost US\$70, and she sent the remaining US\$50 home to pay for her two children's living and education expenses. Ratha now has to make her husband's nominal income support them both.

Ratha wants to run a grocery store, but she does not have any capital. She could borrow the money from a money-lender, but does not want to run the risk because she sees that there are fewer buyers in the market. Ratha thinks that the Government should create more jobs for the laid-off factory workers, especially by keeping the garment factories operating because they provide jobs for women from rural areas with little education.

Ean Chen:

Single, 19-year-old Ean Chen lives in Kampong Speu and has been a garment worker since late-2006. She makes US\$80 per month, US\$40 of which is allocated to supporting her family of five and she spends the balance on her food and transport to work and small amount of discretionary income. In December 2008, she was temporarily laid-off when her factory ran out of orders. Chen applied for jobs at two other factories, but has not been contacted by either of them. Chen and her family struggled financially while Chen was unemployed because neither Chen nor her family had any savings.

Chen was called back to work in April 2009, but only on a month-to-month contract. The contract can be renewed on a monthly basis as required by the employer. The employee has no recourse if the employer decides to dismiss the employee or discontinue the contract. Even though Chen has to work hard and is sometimes treated badly by her employer, she still wants to be a garment worker because she does not have any other skills. Chen wants the government to protect workers from exploitation and help them negotiate better salaries, between US\$90-100, to allow them to afford decent living conditions.

Neth Sophal:

Neth Sophal was laid-off from a garment factory in March 2009 after working there for three-and-a-half years. Luckily, Sophal has hairdressing skills, so she got a job at a hair salon after she was unsuccessful in finding a job in another factory.

As a garment factory worker, Sophal made US\$85 per month. Although she wasn't able to save any money, she did manage to send US\$30 per month home to supplement her family's income.

She only earns US\$35 per month working as a hairdresser. This is barely enough to pay for her food and accommodation. Her family has undoubtedly suffered.

Sophal expects to return to work at the factory, but she does not know when the factory will reopen. Sophal could open a hair salon by herself, but in the current economic climate, she is afraid that it's not a good time to start a new business. She hopes that there will be more factories to provide jobs for poor and under-educated girls and women since they don't have many choices. However, she thinks factory workers' salaries should be from US\$80-100.

Source: UNDP interviews, 12-18 May 2009

4.1.2. CONSTRUCTION WORKERS

There are no clear statistics on how many construction workers have been laid-off because the industry generates a great deal of informal employment. The construction industry generates about 3.6 percent of total employment or 270,000 jobs. It is one of the sectors that have been directly affected by the global economic crisis, and the subsequent cut in spending on FDI projects and by domestic firms. Tens of thousands of jobs are estimated to have been lost in the last eight months.⁴⁰

BOX 3: LAID-OFF CONSTRUCTION WORKERS

Interviews with 10 laid-off construction workers, all between 21 and 29-years-old, showed that they had been earning between US\$40 and US\$180, significantly more than garment workers. Most were being paid on a daily basis. They had been able to save around US\$44 per month to support their families, a substantial amount in a country where the poverty line is half a dollar a day.

Six of the ten laid-off workers had found other paid work after they were laid-off. However, they were earning less money than before. The remainder of the workers were doing unpaid labour for their families or were unemployed and continuing to seek employment. Most were staying with their families in rented accommodation. All were worried about not having enough money if they or their family members fell ill.

They raised the issue of not receiving full payment from previous projects they had worked on. Some had even received no payment at all. When asked what assistance they wanted from the government and civil society, most called for the government to try and attract more construction projects and for vocational training in skills such as plumbing, electricity and other construction skills to be provided.

Source: UNDP interviews, 12-18 May 2009

4.1.3. TOURISM INDUSTRY WORKERS

A rapid assessment conducted by the ILO in March 2009 reported that while there have not been massive layoffs in tourism, underemployment has increased and will likely result in declining income.⁴¹ Workers in the tourism industry, including those working in hotels and guesthouses, travel agencies and tour operators, tour guides, restaurants, massage shops, souvenir sellers, and transportation workers, were still holding on to their jobs though the self-employed were making less money. Since April 2009, the situation has deteriorated as a result not only of the impact of the global economic downturn, but also due to potential fears of contracting Influenza A(H1N1). Opinion is divided as to the level of the impact of Influenza A(H1N1) on the recent fall in tourist arrivals.

⁴⁰ Chandarot, Kang, Sok Sina, and Liv Dannet. Rapid Assessment of the Impact of the Financial Crisis in Cambodia. Bangkok: ILO Subregional Office for East Asia, 2009.

⁴¹ Chandarot, Kang, Sok Sina, and Liv Dannet. Rapid Assessment of the Impact of the Financial Crisis in Cambodia. Bangkok: ILO Subregional Office for East Asia, 2009.

The most drastic reduction in business activity was evident in Siem Reap, the largest tourist city in Cambodia due to its ancient temples. Hotel occupancy in the first quarter of 2009 decreased by 40 percent leading to the temporary closure of a number of hotels, according to a hotel association official. The severity of the decline, which reportedly started after Khmer New Year in mid-April 2009, is regarded as being caused by a combination of: (i) the global economic downturn, (ii) Influenza A(H1N1) fears, (iii) the low season, and (iv) events particular to Cambodia, for example, the Government's decision to close gambling clubs and football betting shops. These reasons were pointed out by small business owners such as restaurateurs, *motodops* and food stall owners, as contributing to the decrease in customers. In 2008, the seasonal decline in airport arrivals was as high as 50 percent between May and January (see Figure 10).

BOX 4. VENDORS IN SIEM REAP

A souvenir seller in Siem Reap reported that he was selling only 30 percent of what he had sold a year ago. He blamed both the global economic downturn and competition from Korean souvenir businesses for the decline. As a result, his household had reduced spending and borrowed money from relatives who did not charge him any interest.

Similar stories were reported by fruit sellers. Business owners interviewed reported that revenues were down by more than 50 percent compared with the same period last year. While those who managed to save money prior to the crisis could get by without too much difficulty, the poor will soon face further hardship if the situation does not improve. Unlike the garment industry, predominantly women, and the construction industry, predominantly men, workers in tourism-related businesses are both men and women.

Source: UNDP interviews, 12-18 May 2009

4.1.4. FARMERS

The ILO rapid assessment in March 2009 found an overall increase in agricultural employment though a decrease in per capita income. The employment increase is due to absorption of laid-off workers from other sectors. Incomes are falling due to the greater supply of workers. Additionally, many farmers made investments during last year's period of inflation when costs were higher, and the global decline in commodity prices this year will result in a decline in revenues.

A nationally representative household survey to assess the impact of high food prices last year found that labour costs had increased by 47 percent and agricultural production costs accelerated by 30-50 percent, partly due to tripling in the price of fertiliser and a 50 percent increase in the price of diesel and gasoline (CDRI, 2008). Cambodian farmers expected commodity prices to stay high and borrowed money to buy agricultural inputs. Unfortunately, the price of these crops has declined drastically and many farmers started to incur losses. The economic downturn is impacting farmers and agricultural workers against this backdrop of indebtedness and false expectations of continued high prices.

According to statistics compiled by the Ministry of Agriculture, Forestry and Fisheries (MAFF), the total area for cultivating cassava in Cambodia increased from 1 million to 2 million hectares between 2007 and 2008. This was caused by the increase in the price of cassava in the first quarter of 2008. Such a massive response indicates that there is potential in Cambodia to put idle land into productive use. Despite the sharp fall in the price of cassava in the second half of 2008, many smallholders continued to grow the crop in the second quarter of 2009 as the price gradually climbed back to about 60 percent of its level in May 2008.

Rubber farmers are also feeling the impact of the economic downturn. After making profits in the first eight months of 2008 when rubber prices rose sharply, rubber farmers have since been hit by the drastic drop in prices from above US\$3,000 per tonne to below US\$900 per tonne. In 2009, producers began to break even only when prices returned to approximately US\$1,500 per tonne, half of last year's price.

Many dry season rice farmers are incurring losses in the same manner as the cassava and rubber farmers. They had paid much higher production costs, but received lower prices for their product. A small area surveyed in Kampong Thom province found that the majority of farmers cultivating dry season rice in the Tonle Sap plains incurred losses for the 2009 season.⁴³

BOX 5. A CASSAVA PRODUCER

Kea is 40-years-old and lives in Ponleu Thmey village, O Arm commune, Keo Seima district, Mondulkiri province. For the last four years he has planted cassava on his six hectares of land. The revenue from the cassava plantation helped to maintain his household at a decent standard of living with a small amount of savings every year, as well as the capital he reserved for cassava cultivation.

When the price of dry cassava chips plunged from 730 riel per kilogramme in 2007, to 250 riel in late 2008, it took all of his profit just to meet the production costs. From 2008 to early 2009 his family has been living on savings.

The problem is in funding new cultivation. To cultivate the land, Kea was forced into debt. He borrowed money from ACLEDA bank, but he could only borrow enough against his assets to cultivate three hectares of his land. He leased the other three hectares to another villager for 1 million riel.

Kea says that he will keep planting cassava hoping that its price will rise again when the world economy recovers. He thinks that the Government should put more effort into maintaining high prices for agricultural products to protect farmers.

Source: UNDP interviews, 12-18 May 2009

⁴³ Does large-scale agricultural investment benefit the poor? Phnom Penh: Cambodian Economic Association (forthcoming).

4.1.5. CAMBODIAN MIGRANT WORKERS

The current economic downturn is likely to result in increased internal migration due to the high number of lay-offs. As discussed in Section 4.2.1, migrant workers have provided income to rural areas through remittances; however these remittance flows will decline with increased unemployment and workers receiving lower income.

INTERNAL MIGRATION

Since the mid-1990s, lured by the prospects of higher paid jobs and a better lifestyle in urban areas, and facilitated by the absence of year-round employment in their home villages, many young Cambodians migrated to Phnom Penh and other urban areas to work in the ever-growing garment factories, booming construction sites and tourism-related industries. Before the global financial and economic crises hit Cambodia, approximately 360,000, mostly young female workers, were employed in garment factories around Phnom Penh, 270,000, mostly young male workers, were earning their living on construction sites across the country and another 70,000 were engaged in tourism-related industries. There is no exact figure for how much these migrant workers send home each month, but a study by CDRI found that 93 percent of them send money home.⁴⁴ It estimates that on average a migrant worker sends roughly US\$20 home each month.

According to these figures, internal migrants send home about US\$150 million per year to rural Cambodia or about 8 percent of the total income of rural households. As a result of the crisis, significantly fewer remittances are being sent home. It is estimated that the lay-offs of between 20-30 percent of workers in garment factories, construction sites and the tourism industry are resulting in a loss of between of US\$30-45 million in remittances.

INTERNATIONAL MIGRATION

As well as internal migration, a large number of Cambodians migrate to Thailand, Malaysia and Korea. Thailand is overwhelmingly the most popular destination for undocumented Cambodians owing to loose or non-existent border controls. Undocumented Cambodian migrant workers abroad, estimated at 200,000-220,000, annually send an estimated US\$300 million⁴⁵ to Cambodia. It was first feared that most of them would be forced to return home as a direct consequence of the crisis in order to free up jobs for local Thais. However, according to the Ministry of Labour and Vocational Training (MoLVT), only a small percentage of them are returning home because they are usually involved in so-called '3D' jobs (difficult, dirty and dangerous), which are largely shunned by Thai workers. Even though only small numbers are returning, remittances from Thailand are expected to decrease as those remaining in Thailand are expected to earn less. There is also a strong likelihood that migrants will begin to return as governments in the region focus on employing national workers.

⁴⁴ Lim, Sovannara. "Youth Migration and Urbanization in Cambodia" (Working Paper 36). Phnom Penh: CDRI, 2007, 27.

⁴⁵ Ratha, Dilip and Zhimei Xu, eds. Migration and Remittances Factbook 2008. Washington, DC: World Bank, 2008. <http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1199807908806/Cambodia.pdf>, 19 March 2008. Web. 1 June 2009.

Table 11. Cambodian migrant workers officially sent abroad since 1998

	Malaysia			Korea			Thailand ⁴⁶			TOTAL		
	Total	M	F	Total	M	F	Total	M	F	Total	M	F
1998	120	0	120	..	..	..	..	..	..	120	0	120
1999	86	0	86	..	..	..	..	..	..	86	0	86
2000	502	307	195	..	..	..	..	..	..	502	307	195
2001	846	342	504	..	..	..	..	..	..	846	342	504
2002	1049	246	803	..	..	..	..	..	..	1049	246	803
2003	573	73	500	756	638	118	..	..	..	1329	711	618
2004	809	105	704	675	519	155	..	..	..	1483	624	859
2005	1776	467	1309	468	432	36	..	..	..	2244	899	1345
2006	1690	231	1459	1501	1341	160	445	226	219	3636	1791	1845
2007	3219	174	3045	584	499	85	5670	3935	1735	9473	4608	4865
2008	2654	53	2601	..	..	..	2116	1425	691	4770	1478	3292
Total	13324	1998	11326	3984	3429	554	8231	5586	2645	25538	11013	14525

Source: MoLVT

Outward international migration has been very limited in 2009 because the host countries are under pressure to create employment for their own workers. Overtime work in factories, a primary source of extra income for migrants, has reportedly been reduced substantially. The security and legal environment has become tougher for migrants entering Thailand illegally. By December 2008, only 8,231 migrant workers had been formally sent to Thailand, while about 180,000 workers entered Thailand illegally.

In early 2009, the number of workers that completed their employment contracts or whose visas expired and had to return from Malaysia, South Korea and Thailand was 6,000, 3,500 and 3,000, respectively. Normally, new migrant workers are sent to these countries, however this has not occurred this year. Thus, prospects for international employment and remittances in 2009 do not look positive.

4.2. SECOND ORDER IMPACT VICTIMS

The term second order impact victims refers to those who are impacted as a result of being dependent on those directly affected by the crisis, and those who have to support the first order impact victims. Through the multiplier and inter-dependency effects, the impact of the economic downturn trickles down from one group to another. The direct impact on these groups of people, in turn worsens the livelihoods of those dependent on them. For instance, laid-off garment workers are first order impact victims of the economic crisis, while their families who received remittances from them or who now have to feed them are also adversely affected as a consequence and are considered second order impact victims. Much of the following assessment is indicative rather than conclusive.

4.2.1. FARM FAMILIES RECEIVING REDUCED REMITTANCES AND RETURNING MIGRANTS

The reduction of remittances from urban to rural areas due to the economic downturn could mean a reduction in investment in productive agricultural inputs such as fertiliser. As farmers are less likely to use fertiliser, agricultural production is likely to decline. In addition there are likely to be lower levels of

⁴⁶ It should be noted that many workers are undocumented and that the actual figure may be closer to 180,000 since 1998.

consumption. With most garment workers sending on average between US\$20-40 per month to support families in rural villages, many households are now going to be without this financial support. Reports from non-governmental organisations (NGOs) and various MFIs state that many households are requesting more time to repay loans and that NPLs have increased from very low levels up to 2.5 percent. If the situation does not improve soon, indebtedness will put increased pressure on rural households and MFIs will face significant financial difficulties. CEDAC, a Cambodian NGO that helped set up 5,000 farmers groups, reported that a number of farm households faced a shortage of funds to create small businesses, as remittances from their household members working in Phnom Penh were drying up.

Another challenge is the return of laid-off workers to rural areas. Fortunately, Cambodian migrants in Thailand continue to work as usual, thus limiting the impact of the crisis somewhat. However migrants are facing increased challenges such as the cracking down by Thai police on illegal migration and the reduction in the availability of over-time work.

4.2.2. CHILDREN OF THE POOR

Last year's food and fuel crises compounded by the current economic downturn have had a negative impact on children of the poor, largely through changes in nutrition, school attendance and the adoption of adverse coping strategies by families such as child labour and the sale of productive assets. In the medium- and long-term, it can also have a negative impact on child labour.

The recent Cambodia Anthropometric Study (CAS) conducted in November 2008 by the Ministry of Planning's NIS, with support from UNICEF and UNDP, suggested that high food prices in 2008 had a significant impact on child nutrition. For instance, the CAS found that wasting among poor urban children was above 'emergency' levels and had risen by over 6 percent, increasing from 9.6 percent in 2005 to 15.9 percent in 2008, exceeding the threshold of 15 percent wasting rate for a 'humanitarian emergency' and calling for an emergency response in urban areas. The study reported stagnation in the national prevalence for child wasting and underweight between 2005 and 2008.

Although poverty was highlighted as an important risk factor for under-nutrition and there were variations in the percentage of thin, underweight, and short children by wealth of the household, the richest wealth quintiles saw elevated rates of all three indicators of under-nutrition. When compared to expected levels in a healthy population, the richest 20 percent of Cambodia has over twelve times more short children (28.6 percent), over eight times more underweight children (19.3 percent), and four times more thin children (8.9 percent). It shows that money, or the ability to buy food, is not the only important factor in nutrition. Other important factors affecting malnutrition include the way children are fed and cared for.

The coping strategies being adopted by families are cause for concern. The squeezing out of health and education expenditures can have long-lasting consequences on child growth and human potential. The most common strategies tend to be food-related. Two out of three households reported relying on less expensive and less preferred food. Other strategies included reducing the number of meals a day, restricting food consumption by adults, and purchasing food on credit. After the food-related strategies, the most common non-food related strategies were reducing expenditures on health and education, looking for alternative jobs, sending children to work, and the selling of productive assets. These strategies could have devastating effects on children's wellbeing through negative changes in nutrition, increased dropout rates and potential exposure to diseases. Such impacts on children's health and nutrition would be long lasting, hampering their growth and the potential of future human capital.

4.2.3. EXISTING URBAN POOR AND NEAR POOR

The poor and near poor have been adversely affected by Cambodia's economic downturn. Some of the urban poor and near poor sell cooked rice and other food to garment workers. As a net number of 50 factories closed due to the crisis, numerous small businesses catering for those workers have been severely hurt. In the case of Siem Reap, which is highly dependent on tourists, the indirect impact on the urban poor and near poor is quite evident. The *tuk-tuk* drivers, *motodop* drivers and food cart vendors reported severe drops in their earnings. This adverse impact was also found among the cart pullers, generally the poor, in Poipet, the largest trading town on Cambodia's border with Thailand. They reported a considerable fall in imports of products that would require transportation by cart. Traders in the town complained that they were operating at only 50 percent of the level they were a year ago. A representative of a Phnom Penh-based company selling cosmetic products who came through this trading town also described a 50 percent drop in imports and sales. The vulnerability of the children of these families to drop out of school and start working can also be high.

BOX 6. URBAN WORKERS

As the nearby factory closed and some workers left, a 19-year-old woman, Srey Neang, who sold cosmetics to factory workers in Dangkor commune in Phnom Penh, could only make 40 percent of what she had earned last year. Her business was only breaking even. As a result, she had to reduce her household expenditures. Worried about being unable to pay rent in the near future, she called for the reopening of the factory.

A 26-year-old woman selling fruit in front of a factory that was now employing fewer workers reported selling 60 percent of what she had sold a year ago. She had to reduce her household expenditures and asked other household members to find jobs because she was making very little profit. She wanted to change to selling groceries, but cited the lack of capital as a barrier.

Source: UNDP interviews, 12-18 May 2009

4.2.4. LANDLESS FAMILIES

Landless families, who account for about 20 percent of the rural population, are vulnerable as they have no land to cultivate crops and often have no money to rent land for cultivation. While they are mobile and can earn daily wages, they are being faced with much less demand for work, for example to clear land. The rural landless have to depend on many activities for their livelihoods. Since economic activities shrunk considerably in 2009, their opportunities to earn cash to buy food have become even more limited. One of the last resorts is to migrate to Thailand to work. However, it is unlikely that the availability of jobs in Thailand will increase. People are, therefore, likely to supplement their lower earnings with their savings until the economy picks up again.

In some parts of Cambodia, however, where good land is abundant and is just opening up to production, demand for labour, although seasonal due to limited irrigation, has not fallen. Areas where labour is still in demand include Monduliri province near Viet Nam, and the district towns of Battambang and Banteay Meanchey provinces near Thailand.

In some parts of Mondulakiri the land is laterite, rich in nutrients and suitable for many crops. Due to the scarcity of labour (Mondulakiri has the lowest population density in Cambodia, with only 4 people per square kilometre according to the 2008 population census), unskilled labourers can earn up to US\$5 per day, compared with US\$3 in most parts of Cambodia, according to fieldwork done for this study and a national representative household survey.⁴⁷ Workers in Mondulakiri largely come from other provinces including Prey Veng, Kampong Cham and Svay Reang where labour is relatively abundant. However, this flow or migration of labour is hindered by the lack of organised information sharing. Informal networks and word of mouth remain the most important channels of communication for rural labour markets.

4.3 REDUCING THE IMPACT ON PEOPLE THROUGH SOCIAL PROTECTION

Social protection, including social safety nets, offers critical support to vulnerable people facing sharp shocks such as the global economic downturn. The concept of social protection, including social safety nets, is not new to Cambodia. Over the centuries, social safety nets have been present, largely through the community, the family and the pagoda, mitigating the impact of multiple shocks. In more recent years, an increased number of social safety net programmes have been carried out by government, development partners and civil society, both local and international. In terms of formal measures, the RGC enacted the Social Security Law in 2002 and in 2008 established the National Social Security Fund (NSSF), aimed at provisions such as civil service pensions and more recently, employment injury, disability benefits and training allowances. However, formal measures remain limited and informal measures remain fragmented. In terms of a coping mechanism to mitigate the impact of this global economic downturn, especially for the first and second order victims identified in sections 4.1 and 4.2, Cambodia has the potential to benefit from a much more developed and integrated social protection system.

Social protection, in its broadest terms, is defined as a set of arrangements and instruments that enable people to manage risks and shocks and ensure a basic level of consumption. Instruments are designed to reduce extreme poverty and to stimulate economic growth. Within this wide remit there are four subsections including:

- i) social transfers to the poor and vulnerable (non-contributory social safety nets) such as conditional cash transfers, labour-based public works schemes and food for work,
- ii) formal social security measures (usually contributory) such as civil service pensions and health insurance,
- iii) regulations and laws relevant to social protection (such as labour market regulations) and
- iv) informal social protection/solidarity mechanisms (based on the family, community and/or pagoda).

4.3.1 EXISTING MEASURES

According to the ADB Social Protection for Committed Poverty Reduction Report, approximately 2 million people benefited from social assistance (social safety nets) in Cambodia in 2007. The following table provides an overview of the largest projects, mostly covering social safety nets but also covering social protection including health insurance and the NSSF. A more comprehensive inventory of existing

⁴⁷ Chan, Sopha. "The Impact of High Food Prices". Annual Development Review 2008-09. Phnom Penh: CDRI, 2009.

measures was published by the interim working group on social safety nets on behalf of the RGC and development partners. This table shows that there are many programmes in place but that coverage remains fragmented and limited.

Table 12. Inventory of social protection projects

Social protection programmes	Government Ministry/ Development Partner	Funding (where figures are available)	Target
Emergency Food Assistance Project	MEF, ADB	US\$40 million (approx. half on social protection measures) 2008-2010	7 provinces surrounding Tonle Sap (initially) Includes free rice distribution, school feeding, cash for work, food for work, agricultural subsidies
Food for Work	WFP, MRD, MoWRAM (and ADB)	US\$3.7million (WFP)	3,500 metric tonnes of rice provided to 113,808 households
School feeding	WFP, MoEYS	US\$8.9 million	470,709 children
Health equity funds	MoH, local NGOs	US\$6 million (govt) US\$7 million (DPs)	47 health centres identified through IDPoor
Community Based Health Insurance (CBHI)	5 main NGOs, MoH	-	75,000 beneficiaries, 6 provinces
Mother & Child Health Scheme	WFP, MoH	US\$2.7 million	57,306 beneficiaries
Child Survival Programme	UNICEF	US\$3.6 million	-
Scholarship for the Poor	MoEYS, WFP	-	21,459 secondary school children, especially girls, by MoEYS and Take Home Ration by WFP (55,000)
National Social Security Fund	MoSAVY, MoLVT	-	Covers employment injury, health insurance, pension coverage. 22,000 retired civil servants
National Vocational Training Fund	MoLVT	US\$6.5 million (2009)	Primarily - but not exclusively - aimed at laid-off garment workers (40,000 total)*
Child Labour	ILO, MLVT, Employers, Trade Unions.	US\$ 4.51 million (ILO) for the period Sept 2004 to Sept 2008 and an additional USD 4.31 million (ILO) for the period Sept 2008 to Sept 2012	15 provinces, focussing on child labour and their families as well as capacity building, advocacy, knowledge building etc.
Workfare	ILO, ADB	US\$4.8 million (ILO) between 2006-2008	Rural infrastructure – landless and farmers during the lean season.

UNDP Cambodia 2009. Figures are from 2008 unless otherwise indicated.

Source: Authors' summary (see Appendix 3)

*Linked to this is an upcoming UN-MoLVT initiative to establish a network of job centres across Cambodia. These are designed to help address immediate employment and training needs during the crisis and long-term structural challenges in the labour market, including the disconnect between demand and supply of skills and the inadequacy of existing employment service provision.

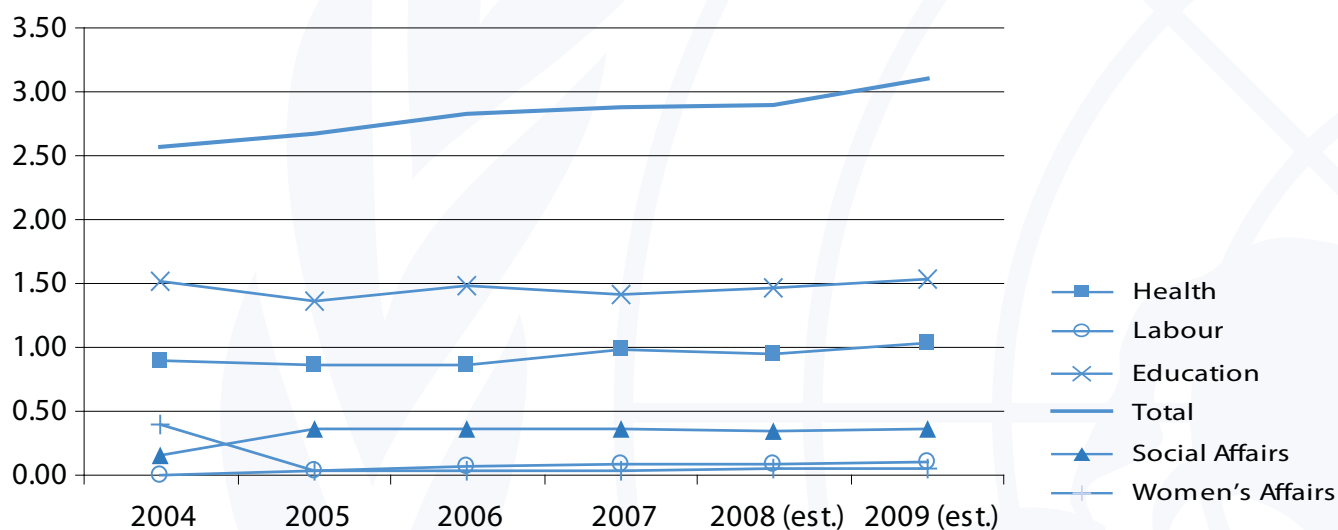
4.3.2 GOVERNMENT SPENDING ON SOCIAL SAFETY NETS

RGC expenditure on social safety nets is among the lowest in the region, at less than 1 percent of GDP. Most developing countries in the region have expenditure rates of between 1 to 2 percent of GDP.

With regard to wider social spending and not just spending on social safety nets, the two largest ministries are the Ministry of Social Affairs, Veterans and Youth Rehabilitation (MoSAVY) and MoLVT. However, almost all government agencies have some expenditure on areas related to social protection. The budget on

overall social spending for social ministries increased by half a percentage point between 2004 and 2009 to 3.1 percent of GDP. Obtaining exact figures on government expenditure and on social protection, and more specifically on social safety nets, and making regional comparisons is difficult due to the spread across different ministries as well as the changes to the current budget structure and the challenge of determining what should and should not be included.

Figure 13. Trends in overall social spending (percentage of GDP)



Source: Ministry of Finance and World Development Indicators

4.3.3 CHALLENGES IN SOCIAL PROTECTION

Using social protection, including social safety nets, to mitigate the impact of the global economic downturn and to achieve long-term benefits, Cambodia is faced with two primary challenges, i) the challenge of sustainable financing and resources and ii) operational challenges including limited national and subnational fiscal capacity. More specifically, challenges include identification and targeting of beneficiaries, engagement of partners at the grassroots level, potential leakages within the system, achieving national coverage, monitoring and evaluating results and delivering quality services such as education and health.

In terms of implementing conditional cash transfers whereby beneficiaries receive cash on condition of fulfilling certain requirements, Cambodia's banking system remains weak. Cash will need to be easily transferable and issues of security will need to be tackled. Conditionalities will need to be fair and reasonable, easily monitored and will require simultaneous provision of high-quality services. Lessons can be learned from international best practice including *Oportunidades* in Mexico and *Red de Proteccion Social* in Nicaragua.

Food for work or cash for work (workfare) requires suitable wage rates to be set below the market wage rate. Workfare is self-targeting which can be efficient, but also rules out participation by certain vulnerable groups such as the infirm or incapacitated. These groups could be targeted using alternative schemes. While directly tackling the challenge of malnutrition in Cambodia, food transfers remain sensitive to changes in food prices, as is evident from the food price crisis in 2008. Food transfers can be logistically challenging and also face issues of sustainability and targeting.



V

MITIGATING THE IMPACT OF THE ECONOMIC DOWNTURN



There are three main strategies policy-makers could consider to mitigate the impact of the global economic downturn on Cambodia namely, i) the development of a **nationally integrated social protection system**, ii) the identification of **effective public expenditure programmes with a focus on equitable access** and iii) **structural reforms** in the areas of economic competitiveness, diversification and agriculture with a focus on long-term recovery and reduction of poverty and vulnerability. These policy considerations are drawn from the preceding analysis and the development priorities that are already well documented.

5.1 DEVELOPMENT OF A NATIONALLY INTEGRATED SOCIAL PROTECTION SYSTEM

Section 4.3 showed how social protection programmes exist, but are fragmented and not always well coordinated. In order to improve its social protection policy, Cambodia is currently developing a nationally integrated system of social safety nets and social security through a formal process initiated in early 2009 at the request of the RGC. In July 2009, a consultative forum was held and attended by both national and subnational stakeholders resulting in a broad dialogue with relevant institutions including line ministries, development partners, civil society and the private sector. It was agreed at the forum to incorporate social protection into the National Strategic Development Plan update for 2009-2013, indicating the high priority being given by the RGC to social protection policy in response to the crisis and for longer-term socio-economic development.

A strategy will be developed by the RGC and development partners in late 2009, which should lead to the development of a nationally integrated social protection system for Cambodia. This is a vital opportunity to contribute to economic recovery and stability in the long-term and for the improvement of human development indicators such as poverty reduction, education, health and gender, and progress towards the CMDGs, by 2015.

A well-designed social safety net system could reduce the impact of the economic downturn on first and second order victims of the crisis as identified in section 4. First order victims, including laid-off workers in the garment, construction and tourism industries, as well as those still in employment but earning less income, would benefit from a system which ensures a basic standard of living, improves income security and food security and enables people to take risks. Vocational training, as provided by MoLVT is an example of direct assistance to laid-off workers which provides immediate benefits to first order victims and could be developed into a formalised integrated system with national coverage. The UNIAP study surveying 357 entertainment workers showed that there are fewer employment options and that indebtedness is rising among this group. Social protection measures can be used as a mechanism to provide options to people whose choices are diminishing as a result of the crisis.

For second order victims, identified in this report as those dependent on remittances, children, the poor and transient poor and landless families, a well-designed social safety net system would reduce the need for negative coping strategies. Examples of these harmful strategies include selling productive assets, pulling children out of school, and taking on debt, as well as being more vulnerable to trafficking. A rise in negative food-related coping strategies was identified by the CAS, including reducing the number of meals and eating less expensive and less preferred food. Furthermore, the increase in wasting among poor urban children is a grave cause for concern. The increase in food insecurity, particularly for children, the transient poor and landless families who do not have access to land as a safety net, emphasizes the urgent need to address vulnerabilities and risks through social protection measures such as cash transfers, in-kind transfers and workfare.

In order to comprehensively and equitably address this web of vulnerabilities and challenges, a nationally integrated, inclusive social protection system is therefore strongly supported by the UN in Cambodia. For such a system to be successful the challenges outlined in section 4.3 will need to be addressed by policy-makers. In addition,

- **Strong commitment and leadership** will need to be maintained if the system is to be financially sustainable and developed in a coherent manner.
- As existing programmes are fragmented, the establishment of a clearly mandated **focal point or central agency** is strongly encouraged in order to coordinate across line ministries.

5.2. EFFECTIVE PUBLIC EXPENDITURE PROGRAMMES WITH A FOCUS ON EQUITABLE ACCESS

The RGC has been swift in responding to the negative impact of the global economic downturn. In terms of fiscal policy, the RGC is running a high budget deficit of 4.8 percent of GDP in 2009, and considers this a form of stimulus package. In addition, the RGC suspended the monthly turnover tax of 1 percent on garment factory expenditures and extended the profit tax holiday for garment factories established prior to 2006. In May 2009, the government provided, through the Rural Development Bank, US\$18 million in the form of loans to a number of rice millers to increase their capacity to purchase and process paddy.

It is suggested that the RGC continue to use fiscal policy as a tool to address both short-term vulnerabilities and to support long-term economic growth with an emphasis on equitable access to the benefits of public expenditure programmes. The RGC has savings of approximately US\$600 million, or 6 percent of GDP, thus providing considerable manoeuvrability for the government to pursue equitable fiscal expansion. While there may be concerns that an increase in public spending could cause depreciation of the riel and lead to high inflation, targeted and effective spending need not lead to higher inflation if focused on productive spending. The threat of inflation is further mitigated given that Cambodia has a managed floating currency regime and has thus far had the capacity to intervene to keep the US dollar-riel exchange rate in a desirable range.

Equitable access to the benefits from increased public expenditure programmes is crucial in mitigating the adverse impact of the crisis. Vulnerable groups, including the first and second order impact victims identified in section 4, would benefit from fair and transparent access to any expanded or new expenditure

programmes. Equitable access means that individuals have equal opportunity to use services such as health, education, and training, and can participate in infrastructure projects. Equity implies access to information on what additional services or new projects are available. Effective public expenditure should ensure that equitable access is adequately addressed. Existing barriers such as geographical barriers, gender barriers and communication barriers should be kept in mind. Programmes that fail to address these barriers could be counterproductive and inadequate in reducing poverty and mitigating the impact of the economic downturn.

Given this, the UN in Cambodia supports:

- **Equitable access to public expenditure programmes** that is effectively targeted at the most vulnerable groups and is designed in an accountable and transparent manner, with sufficient awareness-building, outreach and access to information. The low participation in the vocational training programme being run by MoLVT, for example, indicates that special outreach efforts are needed to ensure that public expenditure programmes are reaching the intended beneficiaries.
- Policy-makers also need to keep in mind **institutional capacity** to ensure that increased expenditure has a positive impact without placing additional pressure on existing structures. For example additional spending may require additional recruitment and procurement procedures. Capacity to implement new programmes as a result of increased public spending may need to be developed.

5.3 STRUCTURAL REFORMS

The economic downturn has highlighted existing structural concerns in the Cambodian economy. These have been well documented, particularly the need to increase economic diversification and competitiveness. The past decade's growth drivers have been severely affected, as outlined in sections 2 and 3 of this report on the macroeconomy and its sectors, and have proven extremely vulnerable to external shocks. The agriculture sector, which has been less affected, also needs structural reform as remittances decline and many laid-off workers return home. A more proactive approach to these reforms is needed if Cambodia is to strengthen its economic foundation for long-term recovery and sustained growth.

When reviewing Cambodia's economic performance, it is important to bear in mind that the economy is affected by both external and internal factors. Past research has attributed much of Cambodia's recent high economic growth to its low initial base, and interestingly, growth in certain sectors appeared to be slowing prior to the crisis, including the garment and tourism industries for example. As industries mature, maintaining high annual growth rates is challenging for any economy. Improving economic competitiveness is therefore an existing challenge, which has been compounded by the global economic downturn.

Given that 90 percent of the poor reside in rural areas and given relatively low agricultural productivity, the agriculture sector would benefit greatly from structural reform. The family farm is regarded as the ultimate safety net in times of crisis, and so the need for reform in the agriculture sector is even more urgent than before. With one of the lowest rates of output per hectare for crops such as rice, Cambodia has huge potential to generate higher income and employment in agriculture through improved agribusiness. Furthermore, the need to expand land titling for smallholder farms has been recommended by many, including the heads of commercial banks. Rural financing is greatly hindered by the lack of land

titles for collateral. The economic crisis could be a catalyst for change and an opportunity for accelerating structural reforms that will benefit Cambodia and its people and reduce vulnerability.

In terms of structural reforms, the UN in Cambodia supports increased economic competitiveness, diversification of the economy and measures to reform the agriculture sector in order to improve agricultural productivity:

- **Increased economic competitiveness.** A recent UNDP study highlighted that Cambodia has among the lowest competitiveness rankings in ASEAN, and that there is therefore much scope for improvement. At the national level, this can be achieved through a proactive human resource policy, a targeted infrastructure policy, the improvement of SEZs and the more consistent application of the regulatory framework. Improving competitiveness is crucial at the sector level, including garments, tourism, agriculture, construction, and ICT. Such improvements will require sustained collaboration among government, development partners and the private sector.
- **Economic diversification.** Initiatives such as the TRADE Sector-Wide Approach, could be expanded, which supports diversification of the economy through the Diagnostic Trade Integration Strategy that highlights 19 goods and services with the greatest export and human development potential.
- **Structural reform of the agriculture sector including land concessions, land titling and increased productivity.** Providing land to rural households that are most in need would improve the rural economy, especially at a time when tens of thousands of workers are expected to return to rural areas. Economic land concessions should be carefully reconsidered to ensure productive, pro-poor and sustainable use of land. Smallholder farmers would benefit from secure land tenure. This will improve capacity to make long-term investment decisions and will result in increased economic activity. Since there is a limit to capacity and resources, land titling should initially target areas that would yield the most benefit, for example, former forestland that has high productivity potential, while adhering to existing land laws.

VI CONCLUSION



The global economic downturn is undoubtedly having a major impact on Cambodia and on the Cambodian people. The first signs of the impact were evident in the reduction of exports in the last quarter of 2008 and a lower economic growth rate of 6.5 percent, after having achieved double-digit growth from 2004 to 2007. Multilateral institutions have forecast the rate of economic growth for 2009 to decline by as much as 2.75 percent. The question now is how to mitigate the impact of the downturn on vulnerable groups, how to work towards long-term recovery and how to take advantage of the opportunities the downturn presents to implement long-awaited structural reforms.

The RGC has employed sound macro-economic policies in response to the economic downturn; however Cambodia has not escaped its effects. This is largely due to limited diversification of the economy and heavy reliance on external demand, markets and capital. The leading industry, garment manufacturing, exported 22 percent less in the first five months of 2009 compared to the same period last year. A great deal of FDI and construction has been put on hold, and the growth in the number of tourists travelling to Cambodia has declined. Only agriculture is expected to continue growing. The recession is likely to be more severe unless demand for Cambodia's garments and tourism turns around considerably in the last quarter of 2009, which as of late September, looked increasingly unlikely. This is negatively impacting not only the tens of thousands of workers who have already lost their jobs, but also women in particular and the 250,000 young people entering the workforce each year.

As a result of low spending multipliers, the rise in unemployment, the fall in the property market, and the drop in commodity prices, the national economy is facing sluggish demand and consumption. Rural households that depend on farming income and remittances are suffering as remittances dry up. Increased indebtedness and difficulties in making repayments are an additional burden. A large number of households may have to dispose of productive assets in order to repay debts. Most of these debts were incurred due to rising farming costs in 2008 when farmers expected higher income from the high prices of crops. As a result, the wellbeing of children, the poor and near poor has likely deteriorated with vulnerability increasing during the annual lean period from July to October.

As the title of this report suggests, the economic downturn can be regarded as both a crisis and an opportunity. It is a serious crisis because the number of people below the poverty line, suffering from income insecurity and food insecurity is likely to increase. It is an opportunity because it provides an impetus to address existing structural weaknesses in the Cambodian economy, as well as to engage in institutional reform and equitable public spending to improve the economy and reduce vulnerability in the long-term.

Cambodia has a number of social protection projects carried out by the RGC, development partners and civil society. These projects are helping to mitigate the negative impact of the economic downturn. However, existing programmes are patchy and fragmented and do not adequately cover the increasing number of households and individuals that now require alternative livelihoods. The development of a nationally integrated social protection strategy is a very welcome development in addressing this challenge. Available government savings could be used for stimulus spending on social protection projects. This will contribute to reducing poverty and improving productivity and competitiveness. Increased public spending will also be most effective if it focuses on equitable access to the services and projects provided.

The current economic downturn is an impetus for the acceleration of structural economic reforms. Early action, along with concentrated efforts by development partners on longer-term issues, is essential if the harmful effects of this recession are not to be repeated. Reforms focused on improving economic competitiveness, increasing diversification and better agricultural productivity could facilitate long-term recovery, reduction of poverty and vulnerability and achievement of the CMDGs by 2015.

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APPENDIX

1. METHODOLOGY

The study was conducted as a rapid assessment over a period of two months. One week was spent on fieldwork in the province and one week on interviews in Phnom Penh. Resources did not allow for new data generation in a nationally representative manner. However, the study capitalises on previous studies and existing data sets and combines them with complementary new field data, as well as the views of experts and those concerned to achieve the objectives. The methodology includes:

ANALYSIS OF AVAILABLE ECONOMIC, SOCIO-ECONOMIC AND EMPLOYMENT/LIVELIHOODS SURVEY DATA

The Socio-Economic Survey of Cambodia in 2004 and 2007, in combination with other surveys (such as the CDRI national level survey of households to assess the impact of the high prices in 2008) are used to the extent possible to identify the most vulnerable groups and their livelihood patterns, as well as their likely vulnerabilities.

Review of relevant findings and recommendations in available economic and socio-economic reports produced by government, UN agencies and other development partners

A large body of reports has been produced recently to identify existing structural problems, as well as the downturn's impact and potential impact on the Cambodian economy. These reports form the basis of a broader understanding of the global economic downturn. In cooperation with the UNDP team, a comprehensive review of such relevant documents was conducted before the fieldwork and interviews began.

DIRECT INTERVIEWS WITH AFFECTED PEOPLE AND COMMUNITIES

Since the study focuses on human impact, it was imperative that new information be collected from individuals, households and key informants identified as primary targets for the study. The research team conducted interviews with vulnerable groups in both Phnom Penh and rural areas, and with key informants such as village leaders, civil society organisations, and families of laid-off workers, as well as laid-off workers themselves, and households severely affected by the downturn in the economy. The consultant, three research assistants, and the UNDP team spent six days in the provinces and targeted communities such as those predominantly growing cassava, maize, soybeans, and rubber that had been suggested by previous studies as having been negatively affected by the global financial crisis, and those communities that reportedly received returning migrant workers from overseas or elsewhere in Cambodia. A specific effort was made to interview laid-off garment workers and construction workers who had returned to their home villages and those who had remained in the cities.

INTERVIEWS WITH KEY GOVERNMENT OFFICIALS/POLICY-MAKERS, EXTERNAL DEVELOPMENT PARTNERS AND PRIVATE SECTOR

The study team interviewed around 20 key informants from these circles to solicit their views and suggestions. Special attention was given to interviewing the organisations (both government and non-governmental) that dealt with vulnerable groups. For instance, the Ministry of Labour had a project to train laid-off workers as a way to mitigate the impact of the economic crisis on them. A number of NGOs are working with migrant workers and have the latest information on the negative impact on them.

CRITERIA FOR INTERVIEWEES AND SITE SELECTION

Talking to people was a very important component of the study since it is essentially about assessing the human impact of the global crisis. We needed to interview not only people who have been directly affected by the crisis, but also those who have knowledge of others and those who have ideas on how to mitigate the negative impact. Thus, four categories were specifically covered in the fieldwork.

- **Laid-off workers:** Individuals laid-off from garment factories and construction projects. A total of 43 laid-off workers were interviewed.
- **Negatively-affected households:** A total of 45 households who suffered loss of income were identified and interviewed.
- **Key informants:** A total of 20 people comprising village leaders, related government officials, business managers, NGO managers/workers, and wholesalers were interviewed.
- **Policy-makers, development partners and civil society representatives** were interviewed. A total of 27 people in this category were interviewed.

The allocated resources and time did not allow for representative sample surveys. In terms of methodology, the idea was, therefore, to generate case studies to complement the bigger picture generated in other studies or by other national level data/indicators. With limited resources and time, the study team collected evidence from areas that are feeling the impact of the global economic downturn. For this reason, the study team conducted interviews and observations in (i) Phnom Penh city, Siem Reap town and Kandal town to examine the effects in major urban areas, (ii) Kampong Cham and Mondulhiri province to reflect the farming areas with crops that have been severely affected by the global crisis, (iii) Kampong Thom, Battambang and Banteay Meanchey province to review the impact on labour migration to Thailand and Malaysia, and (iv) Kampong Speu, Kampong Thom and Phnom Penh to cover the garment and construction workers laid-off as a result of the economic downturn.

2. LIST OF INTERVIEWEES AND INSTITUTIONS CONSULTED FOR THE STUDY

Name	Position and affiliation	Main area of interview
Government		
1. H.E. Dr. Hang Chuon Naron	Secretary General of MEF, Permanent Vice Chairman of SNEC	Macro-policy and general advice
2. H.E. Dr. Vong Sandap	National Project Director, Emergency Food Assistance Project, MEF	ADB-Government project to help the poor and provide social safety nets
3. H.E. Sok Sopheak	Director General, MoC, Advisor to MoC	Trade related issues
4. H.E. Mean Sophea	Director, Multilateral Trade Department, MoC	Trade related issues
5. Mr. San Phirunna		Trade related issues
6. H.E. Seng Sakda	Director General, Ministry of Labour and Vocational Training	Impact on labour migration
7. H.E. Dr. Heng Sour	Director General, Ministry of Labour and Vocational Training	Training programme for laid-off garment workers
8. Mr. Mak Soeun	Deputy Director of Agricultural Extension, MAFF	Agricultural services for small farmers
9. Mr. Horth Vanny	Office of Statistics, MoT	Impact on tourism
External Development Partners		
10. Mr. Neak Samsen	Poverty Specialist, World Bank	Interventions on the poor
11. Mr. Stephane Guimbert	Senior Country Economist, World Bank	Macro-economic situation
12. Mr. Eric Sidgwick	Senior Country Economist, ADB	Macro-economic situation
13. Mr. Tuomo Poutiainen	Chief Technical Advisor, ILO Better Factories Cambodia	Impact on labour
14. Ms. Liu Xuerong	Programme Officer, WFP	Implementation of social safety nets
15. Mr. Khim Ratha	Programme Officer, WFP	Implementation of social safety nets
16. Mr. Peter Leth	Monitoring and Evaluation Specialist, UNICEF	Impact on children
17. Mr. Khoun Bunny	National Coordinator, UNIFEM	Labour migration
18. Mr. Koksi Thanit	Programme Officer, UNIFEM	Labour migration
19. Mr. Kaing Monika	Business Development Manager, GMAC	Impact on garment
20. Mr. Luu Meng	Cambodia Hotel Association	Impact on hotels
21. Ms. So Phonnary	Executive Vice President and Head of Credit Division, ACLEDA	Impact on credit
22. Mr. Vann Tho	Vice President and Deputy Head of Credit Division, ACLEDA	Impact on credit
23. Mr. Mam Choeurn	Representative of Angkor Microfinance Kampuchea	Impact on credit
24. Ms. Haidy Ear Dupuy	Advocacy and Communications Manager, World Vision Cambodia	Impact on rural poor
25. Dr. Yong Saing Koma	President, CEDAC	Impact and interventions on farmers
26. Mr. So Sovannarith	Research Fellow, CDRI	Studies on the poor and impact of GFC

3. SOCIAL PROTECTION MEASURES

EDUCATION

There are plans to expand the Education Sector Support Programme 2006-2010 through the FTI (fast track initiative) Catalytic Fund. The scholarship for the poor programme has provided scholarships in the region of US\$20-60 per year to over 55,000 children since 2006. The Ministry of Education is working with UNICEF to improve the quality of education through the Child Friendly School programme.

HEALTH EQUITY FUNDS (HEFS)

HEFs are being provided in 50 health operational districts and are generally regarded with high satisfaction, as is evident by their rapid expansion since 2000. HEFs operate by a third party compensating the service provider for revenue foregone through fee waivers. Patients' bills are paid for, mostly by donors, but also by government. Users are compensated for travel and food. HEFs are faced with challenges such as quality of services and access to services, but are deemed to be successful overall.

COMMUNITY-BASED HEALTH INSURANCE INITIATIVES (CBHI)

These are voluntary schemes targeted at people above the poverty line who can afford to contribute a small amount to an insurance fund. Users pay small premiums ranging between US\$1-3 per month. They are implemented by five NGOs and have grown in recent years. HEF and CBHI both form an integral part of the development of the Social Health Protection Master Plan under the Social Health Strategic Framework.

EMPLOYMENT GENERATION THROUGH PUBLIC WORKS

The government has endorsed labour-based appropriate technologies to generate employment through improvement to and maintenance of essential rural infrastructure. The ILO and ADB have provided assistance to the government in implementing the Mainstreaming Labour-Based Road Maintenance to the National Road Network programme. Between 2006 and 2008, the ILO channelled nearly US\$4.8 million to the project. Between 2007 and 2008 ADB also provided US\$690,398 to the programme. It is envisioned that most of the beneficiaries from this programme will be men, however, women are targeted in training programmes being run by the Ministry of Labour.

MEASURES IN THE FORMAL SECTOR

Civil service pensions and veterans' benefits are the two largest programmes in the government formal sector. They remain limited in scope and in target. The NSSF was established in 2008 aims to expand social protection measures through employment injury coverage, health insurance and pension coverage. Under the social health protection strategy, health insurance will become mandatory for formal sector employees. There is much room for the expansion of formal social protection measures.



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