1. Background

As the world economic recession spread from the US and Western Europe to Asia, Cambodia found itself exposed through its export and FDI channels. Falling Western demand for its exports, coupled with stalling foreign investment in key sectors led economic growth into a steep decline in 2009. According to IMF estimations, GDP growth in 2009 fell to more than 10 percentage points off 2007 levels (Figure 1). Although the extent of this decline remains disputed, it is clear that this slump made Cambodia one of the hardest hit countries in Asia.¹

**Figure 1: GDP and sectoral growth**


The export sector was hardest hit. In 2009, Cambodia’s merchandise exports fell by 17.0 percent – the bulk of which can be explained by the drop in garment exports to the US. Value added in this sector shrank by 4.3 percent in 2009.² Private consumption as a proportion of GDP also fell by 8 percent—a trend driven largely by falling agricultural commodity prices (which depressed farmers’ incomes) and the spike in joblessness among urban industrial workers. Growth in gross fixed investment also slowed in 2009.

**Figure 2: Sectoral Vulnerability**

Note: The higher the value of these indicators, the more the vulnerability of the subsector to the crisis.

Source: Author’s calculations from based on NIS statistics and CIDS (2009)

¹ Government figures point to 0.2 percent growth, while international agencies such as IMF and World Bank suggest a contraction of 2 percent.

² IMF (2010) World Economic Outlook
The vulnerability of different sectors to the crisis depended on their reliance on exports and foreign investment. Figure 2 illustrates sectoral vulnerability of selected economic activities in industrial and service sectors, measured by export share of output (x-axis) and FDI share of capital source (y-axis). It also indicates sectoral employment share (the larger the circle, the larger the share of employment).

Owing to high export and FDI dependence, the hardest hit subsectors were textiles and garments, construction, and to a lesser extent tourism. These represent three of the four key pillars of the Cambodian economy (the fourth being agriculture and constitute the major share of non-agriculture employment.) Figure. 3 on Garments exports shows the steep decline. Though tourist arrivals continued to grow in both 2008 and 2009 (at 5.5 percent and 1.7 percent, respectively), this growth was significantly down on historical trends. In 2009, arrival declines from Western nations were partially offset by growth from nearby markets, namely Vietnam and Lao PDR (Figure. 4).

Owing to Cambodia’s small population and workforce, the absolute numbers retrenched during the crisis were lower than in other Asian economies. This situation was further helped by the resilience of the agricultural sector—which in Cambodia continues to support some 60 percent of working people. However, for the industrial and service sectors, which in total employ 40 percent of workers, estimates suggest more than 108,000 jobs were lost—with 70,000 going in the garment sector alone. This is likely not only to have pushed up unemployment, but also exacerbated the already persistent problem of vulnerable employment defined as the sum of own account workers and unpaid family workers. The share of vulnerable employment in 2008 was already as high as 82.5 percent.

In the rural agricultural sector low productivity combined with small land plots often make for unproductive employment. This situation is likely to have worsened with the addition of surplus labour laid off from the urban formal sector (garment factories and construction sites, for example).

\[\text{This reflects gross job losses. It is worth noting that many factories have since begun to re-hire (in addition to those that have newly opened), albeit often cautiously, and in some cases using shorter and more casual contracts.}\]

2. Monetary Policy: Options in a Dollarized Economy

Given Cambodia’s special characteristics as a dollarized economy, the use of monetary policy to maintain macroeconomic stability is somewhat more constrained than in other countries. The Country’s central bank—the National Bank of Cambodia (NBC)—reacted to the economic downturn by increasing the monetary base (by expanding M2, broad money supply), so as to help liquidate the credit market. As a proportion of GDP, broad money rose more than ten percent to 37.6 percent in 2009—the highest in a decade. Narrow money growth also

![Figure 3: Garment Export Performance](source)

![Figure 4: Share of tourists by country of origin, 2009](source)
expanded from minus 4.8 percent in the second half of 2008, to 21.7 percent in the first half of 2009.

Almost 60 percent of Cambodia’s monetary base was in foreign currency. The high share of the US dollar in particular in the country’s liquid cash and non-cash components implies a weak capacity for monetary expansion in the domestic economy. With most transactions in the country being made in dollars, policy movements affecting the local currency – the Riel (KHR) – tend to have little effect on everyday business and financial activity and behaviour. In this regard, the expansion of broad money between 2008 and 2009 had only nominal impact on credit growth in the financial sector. After expanding by some 55 percent in 2008, credit growth slowed dramatically in 2009 to just 6 percent.\(^4\)

As long as the dollar remains the de facto medium of exchange and wealth accumulation in Cambodia, monetary expansion of the Riel will have limited impact on the cost of finance and borrowing behaviour of individuals and firms. In this context, interest rate policy remained largely ineffective as a tool to inject liquidity to the banking system and stimulate private borrowing and investment, and thereby employment.

With monetary policy highly constrained, adjusting reserve requirements has been another important policy instrument for macroeconomic stability. In February 2009, the NBC slashed commercial bank reserve requirements from 16 percent to 12 percent, the intention being to boost bank assets and credit availability – a major issue for small and medium sized enterprises. However, owing to continuing negative market sentiment, this measure largely failed to produce the desired effect. To avoid liquidity shortages, commercial banks accumulated deposits, which rose from US$2.5 billion in 2008 to US$3.3 billion a year later.\(^5\)

The NBC also relaxed restrictions on real estate lending, eliminating the maximum 15 percent cap on loans to the sector. Alongside its efforts to boost bank liquidity, this measure was designed to stimulate investment in the flagging construction sector, and with it, kick-start employment and consumption growth.

### 3. Fiscal Policy: Employment Initiatives

Given limited scope and capacity of monetary policy, the government used fiscal policy to boost aggregate demand during the crisis. Unable to launch a large scale economic stimulus due to its limited fiscal space, the Cambodian government pursued fiscal expansion during 2008 and 2009, through a combination of state spending and targeted tax relief to hard-hit sectors. This more than doubled the budget deficit, which rose from less than 3 percent of GDP pre-crisis to nearly 6 percent in 2009. Figure 5 charts the changes in the fiscal balance as percentage of GDP, along with FDI and industrial production.

![Figure 5: Fiscal Balance and FDI Growth](image)


Together with a resilient agricultural sector and unprecedented donor support, these measures helped prevent a deeper recession in Cambodia. In previous years, agriculture was viewed as a laggard, growing more slowly than other key sectors. However, with sustained expansion of around 5 percent throughout the crisis, the agricultural sector helped not only provide a residual spur to growth in the economy, but also absorb workers laid-off from the urban formal sector.

Despite these counter-cyclical policies, there were no strong employment initiatives in Cambodia. The most prominent labour market intervention was the Prime Minister’s Special Fund, which provided

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\(^4\) Year-on-year growth for the year ending December 2009

\(^5\) IMF (2010) World Economic Outlook
state-subsidised training to some 40,140 workers in a variety of technical and vocational subjects (56 percent women). The scheme, worth around US$6.5 million, was aimed predominantly at the newly retrenched -particularly garment workers, who due to their skills set faced acute problems in finding alternative work outside the factories. On all courses, basic business skills were also taught, in an attempt to generate new entrepreneurs in the SME sector. Anecdotal evidence, however, suggests that the main beneficiaries were students and school leavers rather than garment workers.

For the majority of workers laid off, state assistance was out of reach, leaving many with only their families to turn to. For many, this has meant leaving the city and returning to their home provinces to help with household chores and/or subsistence farming. This trend added to the surplus of agricultural labour in rural Cambodia, something analysts believe has depressed wages and productivity still further. In addition to this, a new trend of “reverse remittances” has also been observed during the downturn, whereby families in the provinces have sent money and food to support relatives in the cities, particularly garment workers, a majority of who are young women.

4. Policies for the garment sector

As part of the government's wider fiscal expansion, the garment sector was singled out for specific support. This included temporary suspension of the 1 percent advance profit tax (levied on garment firms' monthly turnover), as well as a temporary reduction in employer contributions to the National Social Security Fund, from 0.8 percent to 0.5 percent. Both measures were intended to give relief to garment firms already struggling with falling export orders and a tightening credit environment. In doing so, it was also hoped that the layoff situation in the sector could be mollified, although the extent to which this ultimately helped is unclear.

After withdrawing the social security reduction in late 2010, the 2011 budget will seek to further withdraw earlier stimulus measures in an effort to ensure fiscal sustainability. However, with economic recovery still highly reliant on external factors (and particularly, the strength of the recoveries in the US and Western Europe), this will remain a delicate task for policymakers.

Boosting trade –by reducing barriers and costs to trade - was another area of assistance provided to the garment sector during the economic crisis. Most of these centred on streamlining official procedures, increasing fee transparency, and clarifying and amending import and export regulations related to the garment sector. Most notable in this regard was the government’s decision to cut export management fees for garment firms by 10 percent, as well as simplify customs clearance procedures for returned goods.

5. Employment Implications

As a dollarized economy, Cambodia’s monetary policy space is rather limited and this is unlikely to change in the foreseeable future. Furthermore, Cambodia has a weak tax base and limited fiscal space. Nevertheless, in 2011 the government's budget was raised by some 11 percent over the previous year. Reforms are underway to improve tax collection and the fiscal space, but it is unlikely that there will be major short term gains.

The crisis in Cambodia has exposed the vulnerabilities of its narrowly focused, highly open economic structure and limited options for productive employment. Economic growth in the decade preceding the crisis was undoubtedly stellar, but structural reforms and accompanying economic diversification is now an issue of major concern. While open unemployment rates remain low at 1.6 percent prior to the crisis, the youth unemployment rate is higher at 3.3 percent. Furthermore population projections indicate a higher growth rate for the working-age population, implying more workers and more young people in the labour force in the near future, adding to the problem of finding decent jobs for all those who are looking for work. In addition, there are serious concerns about the quality of employment as pre-crisis figures indicate 82.5 percent in ‘vulnerable employment’ – a large share of which is likely to work in the informal segments of the economy, with low skills, low earnings, and poor working conditions.

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6 EIC (Cambodia Economic Watch, Jan 2011)
7 Defined by the ILO as the sum of own account work and unpaid family work.
Furthermore, by affecting the main growth sectors, and those which provide the bulk of formal employment, the recent economic crisis has exacerbated the decent work crisis in the country.

This has prompted the government accelerate the development of a comprehensive social protection strategy – The National Social Protection Strategy for the poor and Vulnerable, which provides a vision for the development of a social protection floor, beginning with the access to basic social protection services – health, education and food, with minimum income support for working age families with children as well as specific vulnerable groups.

In the long run social protection strategies would need to be financed domestically, and this raises important issues of improving the fiscal space for the country. Furthermore, as already mentioned, levels of vulnerable employment are high, as is inequality (Gini is 0.43 in 2007). It is essential that macroeconomic policies in Cambodia are conducive to productive employment generation. The development of the National Employment Policy could address this, amongst other issues.

The spiralling cost of food and fuel prices present additional policy challenges for Cambodia. Although rice prices have remained stable following the November harvest, they remain 60 percent higher than in early 2007—a boon for some farmers and traders, but a burden for net food buyers like the landless and urban poor. Prices of other foodstuffs, meanwhile, have risen sharply: the price of vegetable oil, for example rose 10 percent between December and January, and more than 28 percent year-on-year. Gasoline prices rose too, by more than 5 percent since December. Together with a rebounding economy and credit expansion, the Cambodian government is now faced with significant inflationary pressures, with limited policy means to address them. Furthermore, the rising prices of fuel and staple foods is likely to be felt among vulnerable groups that spend a larger proportion of their income on these items, threatening health and poverty reduction.

The recently updated National Strategic Development Plan sets out ambitious development targets for the 2009 to 2013 period, including a per capita income level of nearly US$1,000, 99 percent net primary school enrolment, and improved rural access to drinking water (to 67 percent of households). Beyond macroeconomic management, which is intended to ensure a stable environment for business and investment, the government plans to focus on lessons learned from the crisis—namely, the need for better social protection and greater resilience and competitiveness in existing key sectors. However, the macroeconomic policy framework would need to be further reviewed, both with regard to the goals as well as the policy instruments, for a more robust approach to longer term growth, structural change and productive employment generation.

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9 Ibid.
10 Phnom Penh Post, 28 January 2011
11 World Bank (2010)