

# **From downturn to recovery: Cambodia's garment sector in transition**

Sukti Dasgupta  
Tuomo Poutiainen  
David Williams

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## Foreword

Cambodia's garment sector has been instrumental in spurring the country's post-war growth and development, becoming a pillar of the economy and contributing in a significant way to export earnings and employment. It was a major benefactor of the market reforms of the early 1990s, which, alongside the country's newfound political stability and a range of trade and investment incentives, encouraged the entry of foreign industrial investors.


The sector's real take-off period began in the late 1990s, following trade negotiations with the United States over access to its lucrative clothing market. Cambodia was granted generous annual quota increases to the United States, on condition that it adopted sound labour policies and adheres to international and its own labour standards in its factories. To help the country comply with these requirements, an International Labour Organization programme of monitoring and reporting was developed (Better Factories Cambodia), the mandate of which was later expanded to include training and management advisory services to help the industry compete in global markets.

Although these early quotas were lifted at the end of 2004 when the Multifibre Arrangement was phased out, Cambodia remained shielded from fully free trade for another four years as a result of safeguard measures imposed on its major competitors, China and Viet Nam. After these were finally removed (in 2007 and 2008, respectively), Cambodia was widely expected to lose out.

The country took a surprising turn, however. Between 1995 and 2006, the industry grew a remarkable 40 per cent per year. But then, shortly after, came the global economic downturn, which began to unfold in Cambodia in late 2008. As demand for Cambodian exports plunged and factories began to lay off staff, it became clear that the very factors that had driven the garment sector's success – external demand and foreign ownership and investment – had conspired to make it highly vulnerable during times of economic distress.

Coming on the heels of the food and fuel price crises, which hit low-income households especially hard, the global economic downturn struck at a particularly inopportune time for the poor in Cambodia. Among formal economy employees, garment workers were among the worst affected groups. Moreover, because many factory workers were supporting their families as well as themselves (through remittances primarily), these crises also threatened the living standards of thousands additional households, typically agriculture-dependent families in the country's impoverished rural areas.

As factory workers' real incomes were squeezed, so too was their ability to send remittances to family members back home. While some workers sacrificed their own well-being to preserve the level of



money sent to their families, others did not have that choice. For those left unemployed by the crisis, the choice was stark: find alternative employment soon or return to the countryside, where shelter and food would be provided but where productive job opportunities would be scarce.

As the economic situation worsened in Cambodia, the ILO and its Better Factories Cambodia programme, in consultation with constituents, conducted in-depth studies on the emerging impacts of the economic crisis on the country's most important formal sector to help inform suitable responses. These studies covered the impact at the worker, factory and macro-economic levels. This book brings together the findings of those individual but coordinated studies, carried out between early 2009 and 2010, to generate a picture and assessment of the state of the garment sector before, during and after the economic crisis. In analysing the impacts, the book also explores scenarios for the industry's recovery and future growth. Altogether, it provides the most comprehensive assessment of the sector to date, including information and data that can be used for economic and social policies in a range of areas crucial to Cambodia's future development.

It also raises fundamental issues concerning the nature and sustainability of the sector in its current structure, the advantages and limitations of its low-wage, low-quality export model and the special features, particularly that of labour compliance, that set Cambodia's garment sector apart from others in Asia.

A study of this vast nature was only possible with the contribution of a number of agencies and individuals, within and outside the ILO. Sukti Dasgupta, Tuomo Poutiainen and David Williams coordinated the research, and in this book they bring together the main findings and raise important sector and policy issues. I am grateful to the United Nations Development Programme Cambodia for the financial contribution towards the tracking study and to ILO and the Better Factories Cambodia for providing funds for the major part of the research. I am also grateful to Stephane Guimbert of the World Bank Cambodia, who made a valuable contribution to this study.

Such a comprehensive study has not been attempted before. I believe the findings and analyses offered here on the opportunities and constraints of the garment-led (or more generally, the low-wage, labour-intensive, industry-led) model of development will be a very useful contribution to the existing literature on garment manufacturing, with far-reaching policy implications.

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Sukti Dasgupta  
Tuomo Poutiainen  
David Williams



## Acronyms

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
BFC	Better Factories Cambodia
CAMFEBA	Cambodian Federation of Employers and Business Associations
CASDEC	Cambodia Skills Development Center
CIDS	Cambodia Institute for Development Study
CMT	Cut-Make-Trim
EIC	Economic Institute of Cambodia
EU	European Union
GDP	Gross Domestic Product
GDS	Global Development Solutions
GMAC	Garment Manufacturers Association in Cambodia
G-PSF	Government-Private Sector Forum
ILO	International Labour Organization
JDI	Japan Development Institute
MOLVT	Ministry of Labour and Vocational Training
MOP	Ministry of Planning
NGO	Non-governmental organization
NIS	National Institute of Statistics
NSPS	National Social Protection Strategy
ODI	Overseas Development Institute
SME	Small and medium-sized enterprise
TVET	Technical and vocational education and training
UN	United Nations
UNCTD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
US	United States of America
WTO	World Trade Organization





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# 1

Overview

## 1.1 Introduction

The global garment trade has endured several major shifts in production in the post-war period. The first shift began in the 1950s when cheaper Japanese producers started to displace production in North America and Western Europe. This was followed a decade or so later by a second shift, from industrialized Japan to the region's newly industrializing states – the so-called East Asian Tigers of Hong Kong (China), Republic of Korea, Singapore and Taiwan (China), which went on to dominate global garment production in the 1970s and early 1980s. Then, as these economies diversified and upgraded their manufacturing bases, a third shift occurred, this time towards mainland China and other emerging economies like Indonesia, Malaysia, the Philippines and Thailand.<sup>1</sup> By this time, global production had become more dispersed, partly because of the international quota regime that placed quantitative restrictions on textile and clothing exports from a range of developing countries.<sup>2</sup> In the 1990s, a fourth, less-pronounced shift occurred, as cheaper and fewer quota-restricted bases emerged in Central America, the Caribbean and Asia.<sup>3</sup>

Cambodia's insertion into global garment production networks began as part of this fourth shift, following the (nominal) resumption of peace and the opening of the economy to trade and foreign investment. The first factories producing garments for export appeared around 1994, with investors from Hong Kong (China), Malaysia, Singapore and Taiwan (China).<sup>4</sup> Recognizing the vast potential of foreign investment as a spur to post-war economic recovery, the Cambodian Government offered a host of incentives to foreign enterprises to set up shop in the country, including tax holidays and duty-free import of machinery and material inputs.<sup>5</sup>

These incentives, coupled with the country's abundant cheap labour and preferential access to lucrative Western markets (Cambodia was not a party to the quota system under the Multifibre Arrangement that its main competitors were bound by) proved

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<sup>1</sup> Gereffi and Memedovic, 2003.

<sup>2</sup> The quota system resulted in the dispersal of sourcing and production across an increasing number of developing world producers, giving rise also to the phenomenon known as "quota-hopping". When quotas in one country became binding, global buyers shifted production to new less- (or un-)constrained locations with unfulfilled quotas, before moving on once more when these quotas were exhausted (Tewari, 2005).

<sup>3</sup> In Asia, the migration of production away from the East Asian Tigers did not signal the end of their involvement in the garment trade. In fact, it formed a conscious strategy of manufacturers who, by that time, had amassed significant technical and managerial experience in operating garment production networks and supply chains. While these countries were happy to see production outsourced to cheaper Asian bases, much of the supply chain coordination remained with them. This was the beginning of what is called "triangle manufacturing" in which orders placed by buyers in Europe and the United States are received by Asian middlemen and coordinated for production in cheap labour bases in the region.

<sup>4</sup> Arnold and Shih, 2010: 405.

<sup>5</sup> Many of these incentives were set out under the 1993 Law on investment, an overview of which can be found in IMF, 2009.

highly attractive to garment manufacturers. Amid the early burst of foreign direct investment in the sector (apparel investments made up nearly a third of total foreign direct investment inflows between 1995 and 2003),<sup>6</sup> the number of garment factories grew rapidly, from just seven in 1994 to 186 in 1999.<sup>7</sup> Industry growth was further buoyed in the late 1990s, after the United States granted Cambodia its most favoured nation status and the European Union signed a three-year preferential trade pact.<sup>8</sup>

In the early years, working conditions in the sector were poor due to weak labour law enforcement, the disproportionate bargaining power of enterprises vis-à-vis workers and widespread corruption.<sup>9</sup> Factory work was long and arduous, and although perhaps higher than most could have expected, wages were still low, at around US\$45 per month.<sup>10</sup> What's more, workers typically had to pay a broker's fee to get the job, which left many in a situation of effective debt bondage to pay them back.<sup>11</sup> Abuses also were common, including forced overtime, illegal pay deductions and failure to pay the minimum wage.<sup>12</sup>

In the late 1990s, however, this situation began to change, first through the emergence and strengthening of the union movement and later by changes to Cambodia's international trade position.

In 1998, amid a mounting domestic lobby highlighting abuses in Cambodian factories, the US Government began bilateral negotiations with the Cambodian Government to determine quota allocations for its garment exports.<sup>13</sup> What resulted was a trade agreement that allowed annual-rising quota levels in exchange for Cambodia's commitment to continual improvement of its labour standards.<sup>14</sup> Much hope was invested in the power of such an agreement to turn the country into a showcase of ethical production for other developing countries while providing proof for the United States that trade policy could link to social and developmental objectives.

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6 UNCTAD, 2005 in: Bailey, n.d.

7 ODI, 2009.

8 Natsuda et al., 2009: 10,11; Arnold and Shih, 2010: 406.

9 Berik and Rodgers, 2008; Arnold and Shih, 2010.

10 Since 1997, wages in the garment sector have been regulated by minimum wage legislation. The first minimum wage was set at \$40 per month and then increased to \$45 in 2000. In 2006, it was increased again to \$55 and again in 2010 to \$61 per month.

11 Pastor, 2005, in Arnold and Shih, 2010. This is a practice that continues to pose problems even today.

12 Arnold and Shih, 2010.

13 As Polaski (2004) notes, labour groups had in 1998 petitioned the Clinton administration to review the alleged abuses of workers' rights in Cambodian factories. This followed a series of sweatshop scandals uncovered by the media in the 1990s, raising public awareness of labour issues in garment-source countries.

14 Officially, this deal was known as the US-Cambodia Trade Agreement on Textiles and Apparel, or TATA.

To help the country comply with these requirements, the International Labour Organization initiated the Better Factories Cambodia programme to monitor labour conditions and provide services towards improving working conditions, management and industrial relations in the sector.<sup>15</sup> At the time, Cambodia was the only country in the world in which such a programme had been made mandatory.<sup>16</sup>

## 1.2 The role of garment production in economic growth

By the early part of the new century, Cambodia was fast establishing itself as an ethical producer of garments – owing to its well-publicized commitment to basic labour standards. This led labour advocacy groups and NGOs to hold it up as a “poster child” for other developing-world producers to follow. This reputation appealed to international brands and buyers, many of whom were keen to dispel the sweatshop image that had tarred the industry’s reputation – and in some cases, those of individual brands – in the 1990s. The monitoring of labour standards rested on the establishment of the Better Factories Cambodia programme, with strong support from government partners and the Garment Manufacturers Association in Cambodia (GMAC) in particular. As a result, third-party monitoring quickly established credibility among industry partners and international buyers, thus helping reaffirm the incentives for all parties to sustain the Better Factories Cambodia programme.

### *The garment sector becomes the leading export sector*

Although a small and otherwise marginal player in the global market, Cambodia used its emerging reputation for labour compliance, together with its preferential trade position, to great effect, almost doubling the value of its exports between 1999 and 2001. This helped consolidate the country as one of the top global suppliers of apparel to the US market – an amazing feat for an industry latecomer with limited volume capacity and a relatively narrow product range.

In addition to its preferential trade position and emerging “compliance” niche, the sector’s growth also owes much to the presence of an effective employers’ organization in GMAC. Following its establishment in 1999, the GMAC earned a solid reputation

<sup>15</sup> The project was originally named the Garment Sector Working Conditions Improvement Project but was rebranded as Better Factories Cambodia.

<sup>16</sup> Dasgupta and Williams, 2009. The US trade deal was accompanied by preferential agreements with the European Union and later Canada, all of which helped define a new era in the industry’s post-war development.

as a strong and capable representative of garment manufacturers in Cambodia, helping coordinate collective action and lobbying for industry interests, reaching negotiated settlements on industrial relations issues and exerting significant influence over sector, trade and business policies.

In the late 1990s and early 2000s, Cambodia's garment exports were shielded from direct competition with larger and more efficient producers, both by its own preferential trade position and the safeguards placed on the exports of other nations. However, with the 2005 phase-out of the Multifibre Arrangement came a new challenge and one many observers saw Cambodia as ill-prepared to overcome. The lifting of the quotas, which had dominated the global garment trade for more than three decades, meant the end of quantitative export restrictions on major global producers. It also presented Cambodia with the somewhat daunting prospect of competing on a more level playing field with the likes of China and India.

By this time, the Cambodian economy had become acutely reliant on the garment sector: in 2003, garments made up 80 per cent of total exports, one of the highest rates in the world.<sup>17</sup> What's more, the vast majority of its products went to developed, quota-restricted markets to which Cambodia had enjoyed prior preferential access. These conditions led many analysts to predict the imminent demise of the Cambodian garment sector amid a global consolidation of garment sourcing towards the larger Asian producers.

This demise did not materialize. Instead, inward investment and exports from the garment sector in Cambodia continued to rise even beyond the end of the Multifibre Arrangement phase-out (figures 1.1 and 1.2). Part of this can be attributed to the replacement safeguards that the European Union and the United States put on Chinese exports, fearing an influx of cheap Chinese goods into their markets. It also was helped by Cambodia's accession to the World Trade Organization (WTO), which promised to widen the country's access to foreign markets and investment and by domestic reforms that reduced the time and cost of shipping garments from Cambodia.<sup>18</sup> Perhaps most important though was the resilience of Cambodia's key modes of competitive advantage: compliance with basic labour standards and low labour costs, which, behind Bangladesh, remained the lowest in Asia. Owing to all these factors, Cambodia ended the first year of quota-free trade as one of only a

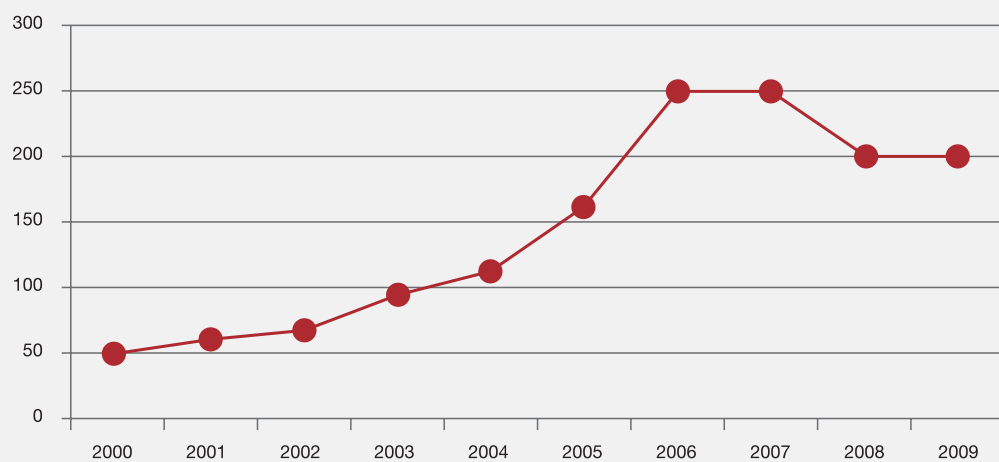
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<sup>17</sup> Bargawi, 2005: 2.

<sup>18</sup> EIC, 2006.

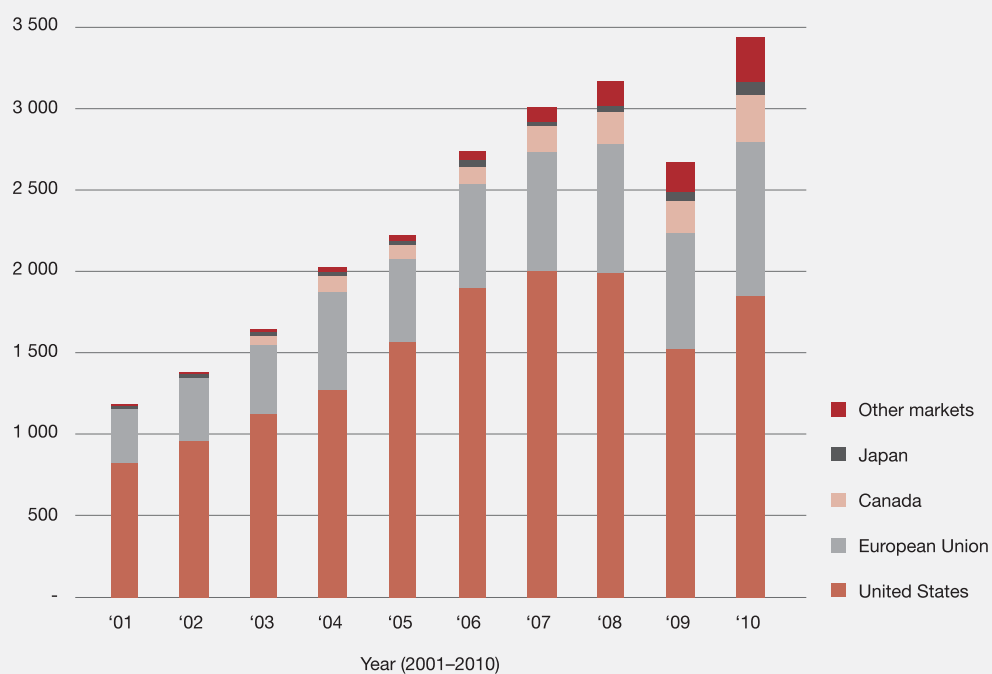
handful of countries to have increased its share of world exports, albeit only slightly (table 1.1).

**Figure 1.1: Inward investment in textiles, wearing apparel and footwear in Cambodia (US\$ million)**



Source: Economic and Public Finance Policy Department, 2010

**Figure 1.2: Total Cambodian garment exports, by key market (US\$ millions), 2001–2010**



Source: Ministry of Commerce



The main export markets for Cambodian garments have been and remain the United States and the European Union, their shares averaging 70 and 25 per cent, respectively, in recent years (figure 1.2). Familiar names dominate the list of buyers sourcing from the country, including sportswear brands Nike, Reebok and Adidas and major chain or brands like Abercrombie& Fitch, Marks & Spencer, Walmart and Columbia Sportswear.<sup>19</sup>

**Table 1.1: Garment exports and share of world exports, selected Asian countries, 2003–2009 (US\$ million)**

	2003		2005		2007		2009	
	Export*	World share (%)**	Export	World share (%)	Export	World share (%)	Export	World share (%)
Bangladesh	5 653.8	2.4	6 889.9	2.5	8 854.85	2.6	1 0725.76	3.4
Cambodia	1 600.4	0.7	2 231.0	0.8	2 851.44	0.8	2 974.27	0.9
China	52 060.8	22.3	7 4162.5	26.6	11 5515.50	33.3	10 7261.15	34.0
India	5 829.2	2.5	8 595.0	3.1	9 932.49	2.9	11 453.75	3.6
Sri Lanka	2 513.2	1.1	2 873.6	1.0	3 271.52	0.9	2 990.52	0.9
Thailand	3 613.2	1.5	4 085.3	1.5	4 073.04	1.2	3 724.50	1.2
Viet Nam	3 464.7	1.5	4 680.6	1.7	7 400.35	2.1	8 628.83	2.7
World	233 815.5		278 423.5		347 059.37		315 621.70	

Note: \* Export (US\$ mill) refers to garment exports at current prices (US\$ million).

\*\* World share is a ratio of garment exports to world garment exports (author's calculation).

Source: International Trade Statistics 2010, World Trade Organization (as of 5 July 2011)

### *The garment sector and Cambodia's economic growth*

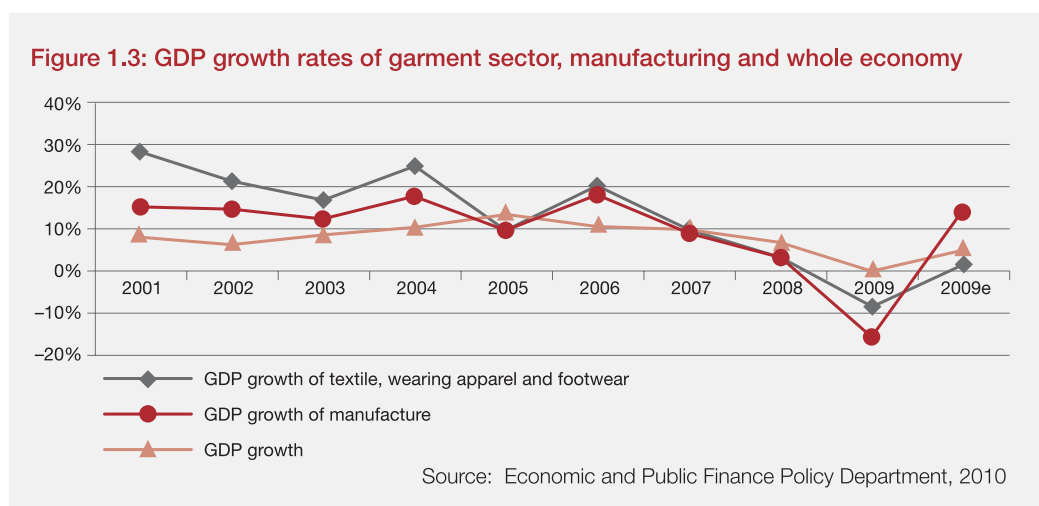
As noted, Cambodia's stellar rates of economic growth (prior to the global downturn) owed much to the performance of its garment sector, which is now one of four economic pillars (alongside agriculture, tourism and construction) and the biggest export earner and formal economy employer in the country.<sup>20</sup> As figure 1.3 shows, since 2001, trends in Cambodia's economic and manufacturing growth rates have been closely linked to rates of growth in the garment sector. In the early part of the 2000s, recorded growth in the sector was high, at over 20 per cent, but declined in 2005 to about 10 per cent. The immediate pre-crisis period still experienced impressive rates of expansion, at around 10 per cent. By this time, other sectors of the economy were also assuming greater economic importance, such as construction (which was booming, particularly in urban and tourist centres) and tourism. But in the past decade, with little other forms of industry of note (least not in terms of outright or export value), the garment sector emerged as the principal driver

<sup>19</sup> USAID, 2005

<sup>20</sup> Heintz (2007: 3) for example, notes that average economic growth in the period 1995 to 2004 was 1.9 percentage points higher because of the direct contribution of the garment sector.

of manufacturing growth.<sup>21</sup> Throughout this time, the special governance context provided to the industry by the Government, GMAC and the Better Factories Cambodia programme ensured that the bulk of the industry was formal in nature, thus assuring in most cases adherence to basic labour standards.

In 2009, at the height of the economic downturn, garment sector growth rates turned negative (-1.5 per cent) before recovering to modest positive levels in 2010 (2.2 per cent) as the global outlook improved and order volumes in Cambodian factories picked up. Illustrating the interconnectedness of the three, the contraction of the garment sector during the economic downturn was also reflected in the deteriorating growth performance of both the manufacturing sector and the wider domestic economy.



As the leading industrial sector, the garment sector has generated important economic multipliers in the rest of the Cambodian economy – even despite its relative lack of physical links with much of this economy. According to the Economic Institute of Cambodia (EIC), a 10 per cent increase in demand for Cambodian-made garments results in a 17.5 per cent increase in total domestic production.<sup>22</sup> Additionally, Cambodia's garment sector can also be viewed as a microcosm of the wider economy: both are narrowly focused (on a few products and/or markets), labour intensive in structure and heavily reliant on foreign investment and demand.

The same factors that helped spur the growth of the garment sector in Cambodia were also causes of the sector's acute vulnerability during the global economic downturn.

<sup>21</sup> Naron (2009) notes that the garment sector has been the most robust of all industry sectors in Cambodia, with an average annual growth rate of 54.8 per cent during 1994–1998.

<sup>22</sup> As quoted in Samsen and Sokha, 2006: 8.

As figure 1.4 shows, the heavy dependence on outside investment and foreign markets put the textiles and garment sectors in an extremely precarious position in the economy. Other sectors such as tourism and transportation were also vulnerable, albeit relatively less so than the garment sector. The size of the circles in the figure indicates the relative size of employment in each of these sectors in 2008; the garment sector accounted for 28 per cent of formal sector employment. Hence, as US and European consumers, who up to that time had purchased more than 90 per cent of exported Cambodian garments, cut their discretionary spending amid tightening credit and employment conditions, Cambodian factories lost orders, prompting many to cut working hours and jobs. The impact was variable but widespread across the sector.

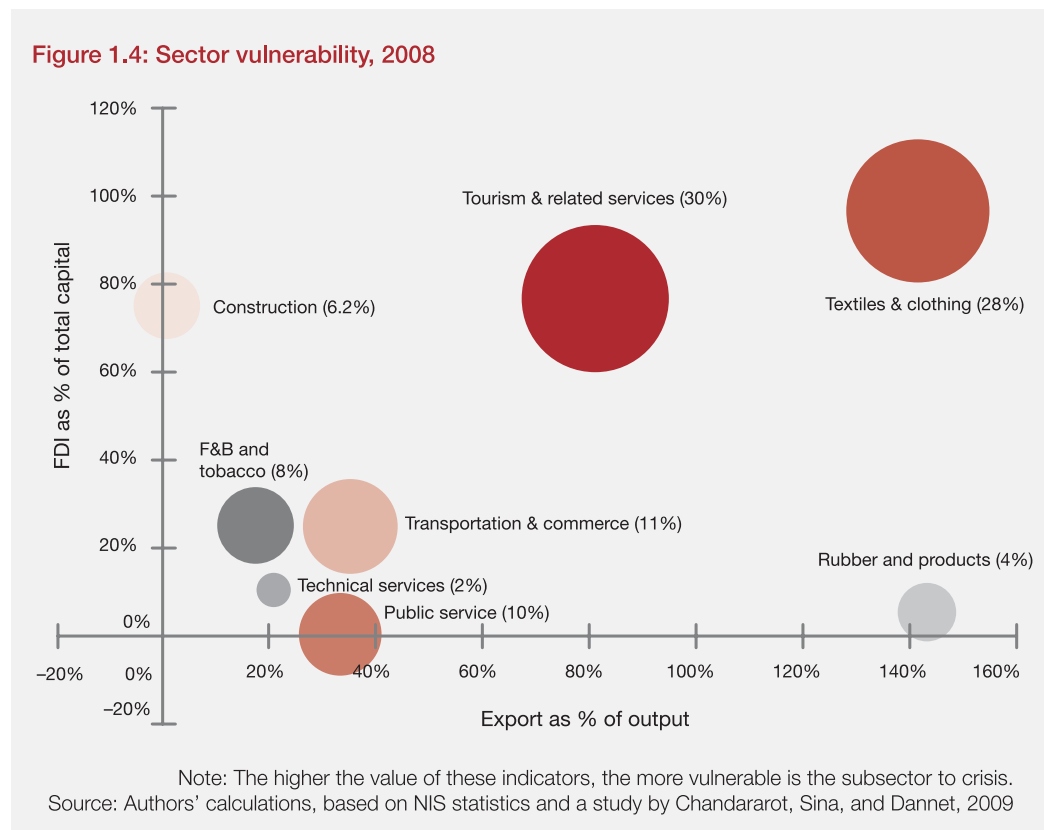
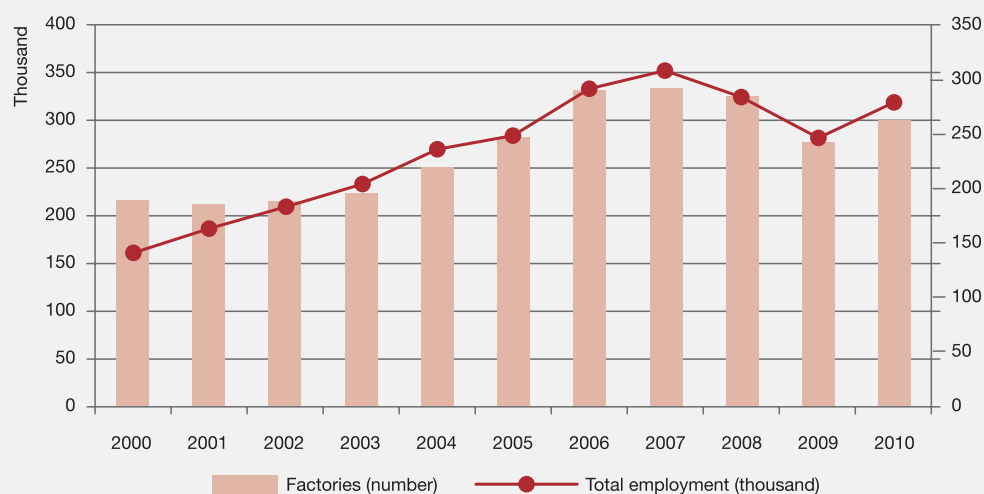


Figure 1.5 charts the evolution of the garment sector growth in terms of the number of factories and employees. It is clear that after a period of spectacular growth, new employment creation in the sector plateaued, from about 2006 onwards, shortly after the phase-out of the Multifibre Arrangement and just before the onset of the global downturn. During the downturn, employment contracted but only for a short period; by 2010, the industry had returned to a trajectory of positive employment growth, although not yet recovering to pre-crisis levels.

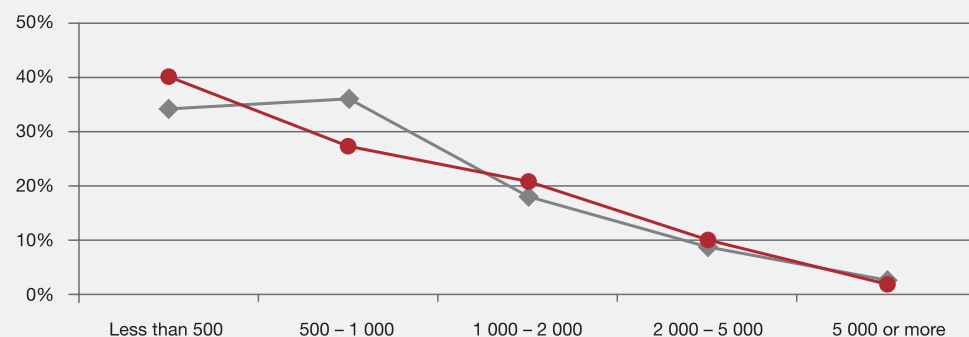
Figure 1.5: Number of factories and total employment in the garment sector



Source: ILO Better Factories Cambodia, 2011

Sector-level data indicate that the crisis also precipitated a shift in the size structure of the sector. Figure 1.6 plots the distribution of enterprises by size in 2007 (before the economic crisis) and in 2010 (after the crisis). It appears that there has been a shift in the size structure within the small groups, which are likely to be more vulnerable to an economic crisis. The smallest group (fewer than 500 workers) increased its share of total enterprises by about 6 percentage points over the analysed period, while there was a decline in the category of 500–1,000 workers. Whether this is a temporary shift as the lower end of the sector adjusts to the economic crisis will become clearer in the years to come, as will the implications of such a shift on workers, if any.

Figure 1.6: Distribution of factory size, by workforce size, 2007 and 2010



Source: GMAC data, 2010

## 1.3 Employment impact through the garment sector

### *Socio-economic context*

Following more than two decades of conflict, Cambodia in 1993 was one of the poorest countries in the world, with no industry, a large rural sector and a poorly educated population. In an otherwise subsistence agricultural economy, the emergence of garment manufacturing brought welcome opportunities for employment for workers with few skills and limited prospects for improving their lives. In economic terms, the sector also provided a critical link to the outside world and one that could generate significant rents – particularly through export revenues – to drive economic growth and provide a basis for (government efforts at) socio-economic development.

The challenges the country has faced, however, have been formidable. Despite the economic contribution of the garment industry, Cambodia today remains a least developed country with a Human Development Index ranking of 124 of 169 economies.<sup>23</sup> Between 1997 and 2007, poverty declined at a moderate pace (particularly relative to its often double-digit economic growth), from 39 per cent to just over 30 per cent.<sup>24</sup> Meanwhile, the country's Gini coefficient, a measure of income inequality, rose from 0.38 in 2004 to 0.43 in 2007, indicating a growing gap between the rich and the poor.<sup>25</sup> In education, the country's relative performance in the region is also weak: In 2008, the literacy rate was 77 per cent, while in neighbouring Thailand it was 94 per cent.<sup>26</sup>

Progress on gender equality has also been slow in Cambodia, and this is evident in the country's low recent standing – one of the lowest in the region – on the United Nations Development Programme's Gender Development Index for Asia.<sup>27</sup> In 2010, Cambodia ranked 95 of 138 countries on the Gender Inequality Index in the UNDP *Human Development Report*.<sup>28</sup>

Although labour force participation among women in Cambodia is high (it was 77 per cent in 2008), the gap between men and women is also large (around 10 per cent in 2008)

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<sup>23</sup> UNDP, 2011.

<sup>24</sup> See table 3.4 in NIS, 2010.

<sup>25</sup> See table 3.5 in NIS, 2010.

<sup>26</sup> UNDP, Human Development Index database

<sup>27</sup> ADB, 2004.

<sup>28</sup> The Human Development Report is an annual publication that features the Human Development Index along with data and analysis on specific issues and policy options; commissioned by UNDP, it is independently produced.

and thus indicative of continued inequalities in terms of women's access to employment.<sup>29</sup> More telling, only 22 per cent of working women are in wage employment, as opposed to 30 per cent of men. More often than not, women find themselves clustered among the ranks of the vulnerably employed – as own-account workers or unpaid family workers with wages and working conditions often among the poorest. Own-account work and unpaid family work make up 85.9 per cent of female employment, as opposed to 79 per cent of male employment.<sup>30</sup> Most of these women work in agriculture and the informal economy, which typically offers low and irregular incomes, arduous working conditions and, in the case of agriculture, vulnerability to natural and weather-related shocks. Because such employment is typically also unregistered, workers usually lack access to other facets of decent work, including organized markets, financial services (including loans and credit), training and skills development, representation through trade unions and protection from exploitation and abuse.

### *The gender dimension of garment sector employment*

The garment sector's influence on employment generation has been critical in determining its human development impact in Cambodia. As Heintz<sup>31</sup> notes, the primary channel through which the benefits of growth can be shared more equally in Cambodia and elsewhere is concomitant growth in employment. This follows from the fact that, as in many developing countries where social protection and basic government services are weak, people's ability to rise out of poverty is contingent upon them having decent remunerated employment. The impact of the garment sector on the livelihoods of the poor, particularly women, has been largely a question of how many jobs and what kind of jobs it has created.

#### **Box 1.1** **Working conditions and gender issues in the garment industry<sup>1</sup>**

As in many other countries, the garment industry in Cambodia is highly gender segregated, with women making up more than nine in every ten workers. Most of these women are young migrants from the rural areas (often near to the capital but also further afield in other rural provinces). Many move to the garment sector out of economic necessity rather than individual choice. Household poverty and scarce job opportunities, together with gendered social norms and family hierarchies, reinforce the particular role that elder sisters in particular play within the Cambodian family: to provide care and support to other family members.

<sup>29</sup> ILO, 2011.

<sup>30</sup> *ibid.*

<sup>31</sup> Heintz, 2007.

What is known about garment factory workers:

- Around 61 per cent of the garment sector's workforce is between the ages of 20 and 29..
- Most come from Kompong Cham, Prey Veng and Svay Rieng provinces.
- Around 17 per cent are younger than 19 years, and only 8 per cent are older than 35 years.
- Around 43 per cent have no education or have not completed primary education; only 4 per cent have attained an education level higher than grade 9.
- The majority remain single (58 per cent), while another third are married, mostly living together with their spouses.
- The majority of married workers (63 per cent) have one child, and around a quarter have two children.

Balancing competing roles of work and the family can be difficult for female workers in the garment sector, especially given the fact that so many are of reproductive age. The labour law provides maternity leave of 90 days and entitles women to 50 per cent of their salary and benefits during that time; however, compliance with those provisions is limited. During pregnancy, workers often depend on internal rules and good will in the factory for easy access to prenatal and postnatal medical check-ups or workload reduction. Pregnant women with short-term contracts often face the additional risk of those contracts not being renewed due to their status. For many others, returning to work is also a challenge: affordable child care facilities are often lacking, and continued difficulties in breastfeeding while at work keeps many women out of a job until their children are older.

Women and men workers experience discriminatory practices at work that start at the recruitment process. Age (being too young or too old), health or pregnancy status and being a man are all common barriers to employment in the garment sector. Once in the workplace, discrimination can also arise due to union membership and participation in related activities as well as over physical appearance and social factors, such as economic class. These issues, coupled with cultural differences in working with foreign supervisors, often translate into misunderstandings and perceptions of aggressive and rude behaviour (on the part of the foreign supervisors). Sexual harassment also occurs and comes mostly from co-workers. There is a lack of mechanisms to deal with such practices and complaints of discrimination, harassment and sexual harassment.

Joint efforts from multiple actors (including the Government, employers' and workers' organizations, international organizations and NGOs) are needed if real improvements to garment workers' working and living conditions are to be achieved in Cambodia. Social protection schemes for workers with a special focus on women's reproductive roles, the establishment of adequate procedures to receive and manage complaints concerning discrimination, promoting women to leadership positions in unions and factory management, and public campaigns to strengthen workers' image and value in society are some of the pivotal measures that should be considered to address these issues.

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Data is from a forthcoming ILO research report on workplace discrimination in Cambodian garment factories: ILO: Social protection and gender project (Better Factories Cambodia, forthcoming 2012).

Between 1995 and 2008, employment in the sector expanded more than eighteen-fold, from fewer than 19,000 jobs to more than 350,000 jobs, with these figures making up the vast majority of total industrial employment. In part due to the low starting point, employment growth was most impressive between 1995 and 2002, when garment factories generated an average of 38,300 new jobs every year.<sup>32</sup> This fell to 15,500 in the 2003–2008 period – a trend that analysts have attributed to falling overall investment in the sector.<sup>33</sup> Although employment gains were comparably more modest by the early 2000s, the sector remained Cambodia’s largest formal employer. In 2006, before the economic crisis, garment enterprises accounted for some 4 per cent of total employment in the country and 27 per cent of industrial employment; about 90 per cent of all workers in the garment sector were women.<sup>34</sup>

In line with global trends, Cambodian garment factories attracted mostly females to their ranks, typically young unskilled migrants from impoverished rural areas hoping to earn money to support families back home.<sup>35</sup> Personal motivations for working in the garment sector were driven by a combination of push-and-pull factors.<sup>36</sup> For most women living in rural areas, the opportunity to earn a formal wage in a factory was a significant “pull” factor, particularly given the hardships many had experienced during the 1980s and the wholesale lack of jobs available at home outside agriculture and the informal economy (both of which are key “push” factors). The incomes on offer in the sector allowed workers to envisage a better life with higher earnings, the potential to save and the opportunity to raise themselves and their families out of poverty. For some, an added motivation was the prospect of greater independence away from traditional pressures of family and community. Together with low education and skills requirements (low barriers to entry), these factors helped generate the conditions for successive waves of rural-urban migration of young women to the growing garment industry.

The opportunities that factories provided for formal, non-agricultural wage employment can thus be considered in the overall country context of widespread poverty, employment scarcity and prevailing gender inequalities affecting women’s chances in the labour market. Although such factors were arguably more pronounced

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<sup>32</sup> Natsuda et al., 2009.

<sup>33</sup> EIC, 2007; Natsuda et al., 2009.

<sup>34</sup> Jalilian, 2008.

<sup>35</sup> Globally, export-based garment industries have provided unprecedented wage employment opportunities for young women because their labour is comparatively cheap, they have relatively lower bargaining power and are believed to be docile (Paul-Majumder and Begum, 2000).

<sup>36</sup> Dasgupta and Williams, 2010.



in the 1990s than they are today (the country is more developed today), many of the same motivations remain for workers to leave the countryside in search of factory work in urban areas. Poverty, for one, remains the single biggest challenge in rural Cambodia, and agricultural incomes are rising more slowly than most sectors in the urban economy.

As the garment industry has assumed greater prominence in the Cambodian economy, so too has the role of women in its labour market. Since the late 1990s, women's labour force participation in the country has increased at a faster rate than men's, while at the same time the gender gap in male-female labour force participation rates has fallen. Much of this was achieved through the garment sector's role in leading both the expansion of the industrial workforce in Cambodia and the feminization of that workforce.

Greater participation of women in the labour market is good for economic growth and development because it raises the employment-to-population ratio, meaning there are relatively more working people to support dependants. A formal economy job with basic rights and benefits, including social security (see box 1.1), can also serve as a means of empowering women, something that is particularly important in a society like Cambodia's, in which gender inequalities are highly prevalent and where few opportunities for formal employment exist.

These developments had important knock-on effects for poverty reduction, human development and the social and economic empowerment of women in Cambodia. Neak and Yem note that by the mid 2000s, about 13 per cent of all rural households received remittances from garment workers and having a daughter or close relative working in the garment sector was considered instrumental in moving families out of poverty.<sup>37</sup>

In spite of these trends, prevailing social norms in Cambodia have continued to devalue the reputation and standing of female garment workers. A 2004 study by the Asian Development Bank revealed that among many Cambodians, these workers were still viewed with suspicion, with a common belief that they were in some way socially corrupted and unsuitable for marriage.<sup>38</sup>

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<sup>37</sup> Neak and Yem, 2006.

<sup>38</sup> ADB, 2004: 6-7.

Furthermore, there are issues with regard to working conditions in the garment industry that need to be improved. Worldwide, garment factories have long been associated with poor working conditions and questionable safety records, which are often related to long working hours, the use of outdated (and sometimes dangerous or faulty) equipment, a lack of workspace ventilation, poor access to medical care and, in some cases, the negative health effects of chemicals used in garment production. The establishment of the Better Factories Cambodia programme came in part as a response to these realities. It is important to point out that while the industry in Cambodia remains one that is low skilled, low paid and hard work, compliance monitoring by the programme has since promoted a more responsible model of (formal) garment production, one centred on a basic and fundamental set of rights and conditions at work and a commitment to the economic and social well-being of its mostly female workforce.

Working conditions in the factories have significantly improved over the past decade since the Cambodian Labour Law (1997) was introduced. Improvements have come by linking trade to labour concerns through trade union work and through a range of industry improvement initiatives – many instituted by factories and international brands sourcing from Cambodia.<sup>39</sup> Despite these developments, challenges remain. Factory-level health services remain poor, and many factories do not fully comply with relevant occupational and safety health requirements or regulations. The most recent industry-wide Better Factories Cambodia synthesis report, released in August 2011, for example, noted continuing problems in the areas of overtime, safety and health.

A 2006 study by the ILO and World Bank looked at a range of health-related issues concerning female garment workers in Cambodian factories.<sup>40</sup> The study showed that fainting/feeling dizzy was the second most common cause of sick leave reported by workers. Another cause reported by managers was insufficient consumption of food and the effects of chemicals/cloth debris, poor hygiene practices and the lack of medical staff on duty during the required working hours. This health issue has become a key concern, with mass fainting events frequent in 2011.

The EIC reported that health condition of workers deteriorates after working for two years or more in garment factories because the workers limit their daily food expenses

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<sup>39</sup> Compliance to labour law and basic labour standards has been linked to access to markets, which has brought about real changes in working conditions in the garment sector.

<sup>40</sup> ILO and World Bank, 2006.

to have money for other purposes.<sup>41</sup> Health services at the factory level remain a pending issue because many factories do not comply fully with relevant occupational and safety health provisions (such as an on-site infirmary, material and personnel). Additionally, little attention is given to other relevant issues, such as family planning and reproductive health or nutrition.

In early 2007, the Government set the minimum wage for garment workers at US\$50 per month and increased it in 2010 to \$61 after long negotiations with trade unions and several large-scale strikes. However, this wage was far below the \$93 that some groups had sought. Some studies estimate the average earnings to be between \$70 and \$100 per month, with working hours spreading from 48 hours a week to more than 60. Garment workers usually send home between 20 and 30 per cent of their income, so very little is left for their own savings and consumption.<sup>42</sup>

Management of overtime is a crucial issue because it affects workers' earnings and their life-work balance. According to the labour law, overtime work must be voluntary and limited to two hours per day, but this is rarely observed. In its latest monitoring report (April 2011), Better Factories Cambodia indicates that only 25 per cent of the monitored factories limit daily overtime to two hours.

The labour law provides for 90 calendar days of maternity leave and at least half salary and benefits in cash and full benefits in kind, provided that the employee has worked for a minimum of one uninterrupted year at the enterprise. The law states that women employees cannot be laid off during maternity leave or at a date when the end of the notice of lay-off period would occur during the leave. Also, the law states that during the first two months after returning to work from maternity leave, women are only expected to do light work. Although the latest ILO monitoring reports show improvement in the number of factories complying with the minimum maternity leave payment (from 55 per cent factories to 73 per cent in the past year), recent studies<sup>43</sup> carried out in a number of factories showed that compliance with the required provisions for maternal health is inconsistent. On the other hand, most factories allow workers to extend their maternity leave for one, two or three months without pay.

Although working conditions have progressively improved, thanks to the collective

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<sup>41</sup> EIC, 2007.

<sup>42</sup> EIC, 2007.

<sup>43</sup> Skau, 2010; Tsier, n.d.

efforts of different institutions, there remains a flipside to the industry's success. The unprecedented opportunities created by factory work for low-skilled women has been undoubtedly positive for human development; but the sector's growth has also created new and largely inadvertent economic vulnerabilities for its mostly female workforce. As the global economic downturn most clearly illustrated, the concentration of women in labour-intensive, export-oriented employment has placed them at acute risk of hardship when external demand and trade shocks occur, due to the fact their employment is inextricably tied to external capital flows and consumer demand in foreign countries.

The global economic downturn first surfaced in Cambodia in late 2008, with factories reporting new pressure on prices and declining order volumes. By late 2009, around 70 factories had closed their doors permanently, and some 70,000 workers – or around 20 per cent of the industry's workforce – had been laid off. For thousands more, new hardships became the norm, many the result of reduced overtime, which eroded workers' real incomes and their capacity to send remittances to family members in the provinces. Although the impact on human development and poverty reduction was not clear at the onset of the crisis, it seemed inevitable that the hardships of factory workers would be passed on to the households that relied heavily on their remittances to sustain basic consumption and investment requirements (for example, in food, fuel, education and health care).



## 1.4 This book

The contraction experienced in the garment sector amid the global economic downturn highlighted the acute vulnerability of the sector and its workforce to exogenous shocks and, arguably, provided illustration of the shortcomings of the growth model Cambodia has pursued since the 1990s. Under this model, new sectors have emerged, economic growth has soared and poverty has been reduced. But the basis for growth has been narrow (limited to just four main sectors), with a huge reliance on external factors – external capital, external demand and external (foreign) management. Hence, when new pressures emerged during the slowdown in Western markets and exports of Cambodian garments declined, previously mooted questions once again resurfaced over whether this reliance was really beneficial or sustainable, both for the sector and for the Cambodian economy.<sup>44</sup>

Of course, although it is not unusual for an emerging economy to focus on exporting particular goods in its early industrial development, it is less common for an economy to develop such a reliance on a single sector. Especially because that sector has remained largely unchanged in an era of global economic pressures that dictate how countries wanting to move to higher levels of development must upgrade, diversify and improve industrial productivity. In Cambodia's case, there were indications even before the global economic downturn that growth rates in the sector (of employment, exports and inward investment, for example) were slowing amid changing external trade conditions and new competitive pressures. Questions were thus already emerging over the possible limits to the garment growth model, particularly given the relative absence of real diversification and upgrading in the sector.

In addition and amid persistent reports of global buyers diverting garment orders to lower-wage, less labour-compliant countries at the expense of Cambodia, the crisis also prompted renewed debate inside Cambodia over the true extent of the industry's commitment to labour standards. Although most employers accept the important role that Cambodia's "ethical" reputation has had in the growth and success of the garment industry, some remain disdainful of this commitment in a global context in which labour standards are ostensibly being displaced by price concerns among buyers and international pressure to raise labour standards in competitor nations has

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<sup>44</sup> Particularly in the year running up to and immediately after the Multifibre Arrangement phase-out, analysts and some policy-makers had voiced concerns over the durability of the garment sector as well as highlighting the limitations of the country's narrow growth model in terms of its ability to fuel the next phase of the country's post-war development.

so far remained limited in comparison to Cambodia (thus allowing them to undercut Cambodia on cost-of-production terms).

The crisis also placed a heavy strain on industrial relations. From its beginning, the garment industry has been home to the only large industrial workforce in Cambodia, along with a high level of unionization, inter-union rivalry and a steady stream of industrial disputes. The establishment of the Arbitration Council in 2003 and the subsequent attention to strengthening the dispute resolution mechanisms greatly improved this situation over the years. The economic crisis posed a new test to the ability of employers and unions to dialogue and to bargain in a fast-changing and deteriorating economic environment.

The study reflected in this book set out to look at the hardships experienced by factory workers during the crisis period as well as the adjustment mechanisms adopted by employers in cases of work suspensions, reduced overtime, retrenchments and the like. Such insights are useful for practitioners and policy-makers when developing appropriate policy responses to ensure that employers have options and that workers are better protected to the extent possible from future undue hardships. Longer term, it is also useful to see if the adjustment of the garment sector during the economic downturn has had any lasting impact, either on the industry or on the welfare and employment conditions of its workforce. Perhaps most importantly, insight is needed as to whether the industry can indeed recover fully from this period and whether it can afford to return to a business-as-usual model of growth in light of its obvious structural vulnerabilities and persistent uncertainty over the reliability of demand from the country's core garment markets.

The book brings together a range of analytical research studies conducted between 2009 and 2010 to document and analyse the changes taking place in the Cambodian garment sector, both in terms of its structure and economic situation and its workforce and employment context. The core analysis centres on the findings of primary research conducted at the enterprise and worker levels that detail and track the impacts of the economic crisis on the garment sector, its employers and its workers and help create a picture of the hardships experienced and the responses and coping mechanisms adopted. The survey data collected are supplemented by smaller research pieces at the macroeconomic level (looking at the garment sector's specific structure, its position in and importance to the Cambodian economy and its competitiveness in global supply chains) and a few case studies of garment workers.



The book is organized into six chapters. Beyond the overview, Chapter 2 provides an analysis of sector-level issues, including the position of the garment sector within the economy and its productivity and competitiveness. It also discusses the sector-level impacts of the economic crisis and measures that were taken to mitigate these effects. Chapter 3 then draws on the enterprise-level research, in addition to studying mechanisms implemented by the industry to cope with the economic crisis, to probe employers' responses that affected production and the production workforce. Chapter 4 is based on the findings of a workers' tracking survey conducted to build a more coherent picture of the economic, social and human impact of the downturn on the sector. Chapter 5 gives an overview of the various responses, the policies and programmes to deal with the crisis in the garment sector. The final chapter considers issues that go beyond the crisis and that affect the garment sector's future. It encourages debate and discussion on how the industry can strengthen its resilience to future shocks and develop more socially responsible strategies when they do occur.

The book draws upon each piece of research individually before bringing the findings together to discuss what this means for Cambodia's leading manufacturing and export sector. This discussion engages with issues affecting external exposure, productivity and competitiveness in the garment sector and considers the ways and means to address these at the policy and programmatic levels. The analysis and recommendations outlined are intended as a basis for both policy development and the organization of future research.



The combined findings of this book provide a comprehensive analytical picture of the garment sector, before, during and after the economic crisis in Cambodia. They contain a wealth of quantitative and qualitative insights that can inform discussions about the state of the industry today, its relative strengths and weaknesses and its prospects for continued growth and competitiveness as well as the economic and social conditions of its workforce, particularly the vulnerabilities that rise amid unforeseen shocks.





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## Macro-level impact: Productivity and competitiveness in Cambodia's garment sector

# 2

## 2.1 Introduction

The ownership and structure of the garment sector in Cambodia has an important bearing on its current and future productivity and its ability to compete in international markets with other developing country producers.

In its formal economy form, the garment sector in Cambodia is almost entirely foreign owned and managed, and these factories are represented in the membership of the employers' organization GMAC.<sup>45</sup> There are also an unconfirmed but likely smaller number of factories that produce for the small domestic market and for other exporting factories, which are both foreign and domestically owned or operated. Overwhelmingly, factories in Cambodia operate at the cut-make-trim stage of production, which is financially and technologically undemanding and generally less profitable than other stages. What's more, because Cambodia does not have a domestic textiles industry, virtually all inputs used in production have to be imported, most commonly from China.

This chapter examines issues concerning the garment sector's productivity and competitiveness before drawing out some related challenges that have implications for the long-term sustainability of the sector.

## 2.2 Shaping productivity and competitiveness

The fate of the garment sector and the Cambodian economy more generally are in many ways intertwined, and this was none more evident than during the 2008 global economic downturn, as discussed in the previous chapter. As Cambodian garment manufacturers baulked under the pressure of declining orders and new pressures to cut costs, the domestic economic picture deteriorated, in line with that of the garment sector. In 2009, overall exports fell by 17 per cent, the bulk of which can be explained by the 19 per cent decline in garment exports in the same period. Additionally, as Naron<sup>46</sup> notes, the garment sector expanded at a robust rate of 58.5 per cent during 1994–1998, and then at 35.4 per cent between 1999 and 2001. But after expanding at these impressive rates, gross domestic product (GDP) growth rates in the garment sector fell to 2.2 per cent in 2008 and then further declined to -1.5 per cent. This

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<sup>45</sup> As of July 2010, GMAC had 247 members.

<sup>46</sup> Naron, 2009: 237

trend was again mirrored in the domestic economy, which in 2009 posted negative GDP growth for the first time in the country's post-war history.

Table 2.1 gives a statistical picture of the garment sector's contribution to the economy before, during and after the crisis. This charts the evolution of the textile, wearing apparel and footwear sectors in Cambodia's economy, starting from 2001 and based on tables provided in the Government's 2010 *Cambodia Macroeconomic Outlook*.<sup>47</sup> Given the known structure of the garment industry in Cambodia, it can be assumed that the principal and major component of this combined category is wearing apparel, or garment.

The garment sector's share of total manufacturing averages 70 per cent – a figure that curiously rises to 82.6 per cent in 2009 when the sector's growth rate was negative. However, total manufacturing growth also turned negative during this period (it declined 15.5 per cent between 2008 and 2009), and hence it could be assumed that although not significant in terms of their shares, other manufacturing sectors experienced greater declines in GDP in 2009, perhaps because of the links they maintained with pivotal crisis-hit economic sectors (garment, tourism and construction, in particular).



The garment sector's contribution to GDP in the past decade has been typically around 10 per cent but rose to as high as 16 per cent in 2006, before declining to 13.4 per cent during the period of the economic crisis. Immediately prior to the crisis (in 2007), the sector's 300 formal enterprises generated exports worth around US\$2.7 billion (more than 80 per cent of total merchandise exports), \$1 billion in value added and almost 350,000 jobs – 5 per cent of total employment and around 70 per cent of employment in the manufacturing industry.<sup>48</sup>

<sup>47</sup> Ministry of Finance and Economy.

<sup>48</sup> This is based on Cambodian data. Export partners report exports some 25 per cent higher. USAID (2007a) calculated value added in garments at around \$1.6 billion. These are analysed in the previous chapter.

**Table 2.1: Share of textile, garment and footwear sectors in the economy and employment (%)**

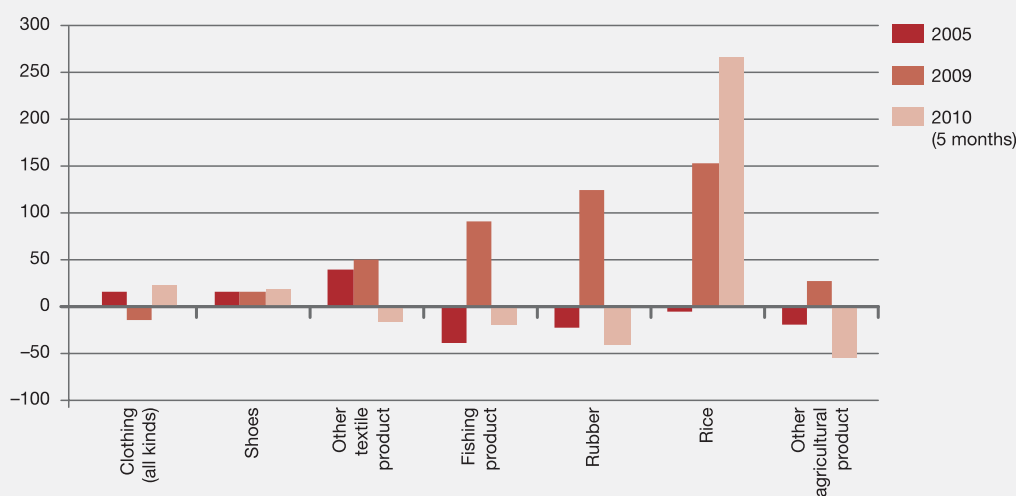
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Share of total manufacture/a	64.2	68.0	70.7	75.0	74.7	76.5	77.3	76.7	82.6	73.4
Share of total GDP/a	10.9	12.5	13.4	15.2	14.6	15.9	15.9	15.2	13.8	13.4
Share of total exports/b	76.2	68.3	75.6	70.8	72.2	68.1	69.7	63.4	69.1	
Total employment in garment (thousands)/c	187	210	234	270	284	334	353	325	282	319
Share of total employment* (%)	3.9							4.8		

Note: \* = The number of total employment is drawn from the general population census, which is conducted every ten years. The total employment in 2001 is thus estimated by the total employment in 1998.

Sources: a) Economic and Public Finance Policy Department, 2010; b) Naron, 2009; c) World Trade Organization, as of 5 July 2011; d) NIS/MOP, 1998 and 2008.

As figure 2.1 illustrates, export growth in garment production turned negative in 2009, following growth in the previous five years, before turning positive again in 2010 as the economic recovery took hold. Figure 2.2 shows that exports from Cambodia into the United States, which is the main destination country for its exports, declined quite significantly in 2009.

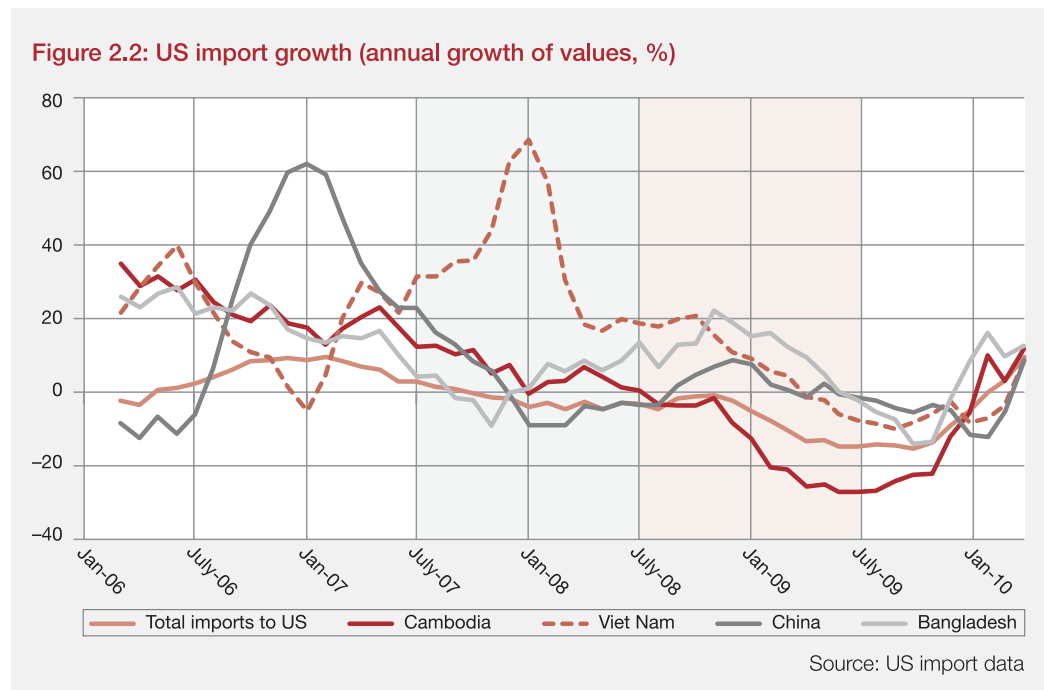
**Figure 2.1: Cambodia's export growth (annual average growth of volumes, %)**



Source: General Department of Customs and Excise, May 2010 (most recent data)

Additionally, since 2005, the sector's export growth has been overshadowed by the performance of other sectors (although not in absolute value terms). This slowdown may be attributed to a number of factors, including: i) Viet Nam's accession to the WTO (and its subsequent gains in investment and exports); ii) slower growth in the US market; and iii) competitiveness issues within Cambodia. Another possible factor is the lifting in 2009 of the safeguard measures that the United States and

European Union imposed on China's garment exports, which may have begun to erode Cambodia's competitive position, given China's massive economies of scale and productive capacity, high productivity from recent investments (in advanced machinery and production techniques, for example) and a well-integrated domestic textiles industry (which reduces production costs and lead times).



## 2.3 The sector's competitiveness

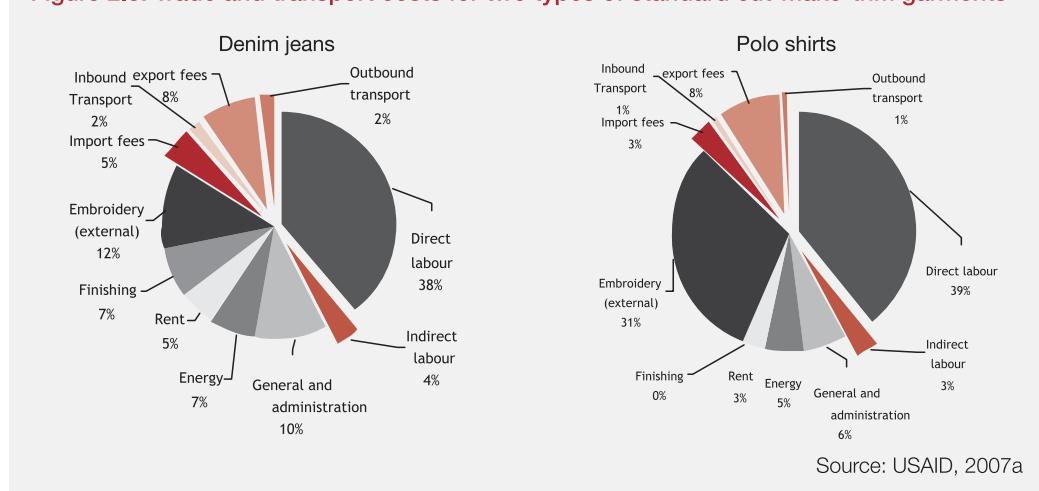
The Cambodian garment sector has specialized primarily in finished garment products, the cut-make-trim (CMT) stage of production. This means factories typically perform only the final stages of production: the cutting, sewing, finishing and packaging of garments, which are then sent to an intermediary buyer (usually in East Asia) who then negotiates with and coordinates the onward distribution of the goods to buyers largely in the United States and Europe.

Around a quarter of factories do, however, cover full operations, which include purchasing the fabric, packaging and shipping the orders to wholesalers or retailers (and in some cases, sample making and direct negotiating with buyers). These activities capture a larger part of the financial benefits in the value chain but also entail significantly higher risks (such as financial risk if an order is not completed

as planned) and require greater working capital. Some 15 per cent of factories are subcontractors, which cover all the major CMT functions, except for the importing of fabric and the exporting of finished products.

This distribution across the CMT, full-operation and subcontracting factories is, in part, a reflection of Cambodia's factories being mostly subsidiaries or affiliates of regional groups, often headquartered in East Asia (half of the country's factories are owned by Hong Kong (China), Taiwan (China) or mainland Chinese interests, with less than 5 per cent of factories owned by Cambodian nationals). These subsidiary enterprises, many of which have grown out of their home country's earlier experience in the garment trade (particularly the East Asian Tigers), essentially serve as middlemen in the garment trade, controlling the client relations and marketing and distribution networks for garments produced in Cambodia for export primarily to the United States and Europe.

**Figure 2.3: Trade and transport costs for two types of standard cut-make-trim garments**



## Costs in garment production

Looking exclusively at the cost of CMT production plus trade and transport costs (but excluding the cost of fabrics and trims), there are only four items that Cambodian garment factories can manage in their highly competitive trade environment:

- The main cost is direct labour (39 per cent in 2009) for cutting, sewing, finishing and quality control. According to a 2009 factory survey, the cost of unskilled labour was significantly lower in Cambodia than in China and Indonesia, slightly



lower than in Viet Nam and higher than in Bangladesh.<sup>49</sup> Another comparison from 2008 (table 2.2) confirms that with the exception of Bangladesh, average unit costs were significantly below those of Cambodia's competitors, including in Asia. The subsequent relative depreciation of the de-facto currency in Cambodia (the US dollar) has probably further strengthened this cost differential (figure 2.4). However, this was more than offset by Cambodia's comparably lower productivity in garment production. In addition, although factory floor wages remain quite low by regional comparison, Cambodian enterprises also recruit a larger proportion of expatriates in management and supervisory positions, which tend to inflate indirect labour costs in its garment sector.

**Table 2.2: Average clothing manufacturing labour costs, 2008**  
(at US\$ per hour, including social charges and average per country)

Countries	Labour cost (US\$/hour)	Countries	Labour cost (US\$/hour)
<b>Asian competitors</b>		<b>US regional suppliers</b>	
Bangladesh	0.22	Mexico	2.54
Cambodia	0.33	Honduras	1.72-1.82
Pakistan	0.37	Dominican Republic	1.55-1.95
Viet Nam	0.38	Nicaragua	0.97-1.03
Sri Lanka	0.43	Haiti	0.49-0.55
Indonesia	0.44	<b>EU regional suppliers</b>	
India	0.51	Turkey	2.44
China 3	0.55-0.80	Morocco	2.24
China 2	0.86-0.94	Russia	1.97
China 1	1.08	Tunisia	1.68
Malaysia	1.18	Bulgaria	1.53
Thailand	1.29-1.36	Jordan	1.01
		Egypt	0.83

Note: China 1 = prime coastal areas (highest labour costs); China 2 = other coastal or core areas;  
China 3 = remote or inland areas  
Source: World Bank, 2010

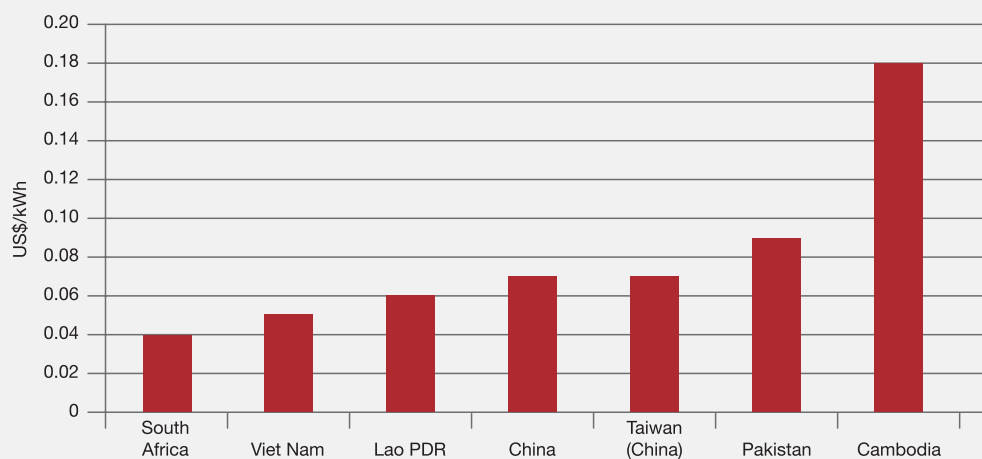
- Indirect labour accounts for 4 per cent of the unit costs. These 20,000–30,000 managerial and supervisory jobs are in large part performed by foreigners because enterprises report that it is difficult to find Cambodians with the skills and attitudes for such jobs. Hiring foreigners for these positions is a significant added cost because they typically command far higher salaries than would be given to an equivalently qualified national.<sup>50</sup>
- Energy costs account for 5–7 per cent of unit costs, a large proportion for an

<sup>49</sup> World Bank, 2009.

<sup>50</sup> World Bank, 2010.

industry with limited demand for electricity. This reflects the high cost of power from the grid and a large proportion of self-generation (enterprises using their own generators), given the unreliability of the grid. Although the price of electricity from the grid has decreased since 2003 (50–18 cents per kWh, with small and medium commercial consumers paying 37 cents per kWh as they source electricity from subcontractors), reliability of supply seems to have decreased and the price of diesel has doubled, hence increasing the cost of self-generation (42–78 cents per litre), as shown in figure 2.4.<sup>51</sup>

**Figure 2.4: Cost of electricity, 2007 (US\$/kWh)**



Source: JDI, 2007a

- Trade and transport costs account for 13–16 per cent of unit costs. Benchmarking against a 2003 value-chain analysis indicates some progress in reducing the costs of inspections and fees but continued high uncertainty.<sup>52</sup> However, compared with other countries, lead times in Cambodia remain very high (table 2.3).

**Table 2.3: Lead time for knit and woven clothing, 2008**

Countries	Woven	Knit
China	40-60	50-60
India	50-70	60-70
Thailand	60-90	50-60
Malaysia	60-90	50-60
Sri Lanka	60-90	60-70
Viet Nam	60-90	60-70
Indonesia	60-90	60-70
Bangladesh	90-120	60-80
Cambodia	80-110	80-110

Source: World Bank, 2010

<sup>51</sup> JDI, 2007b.

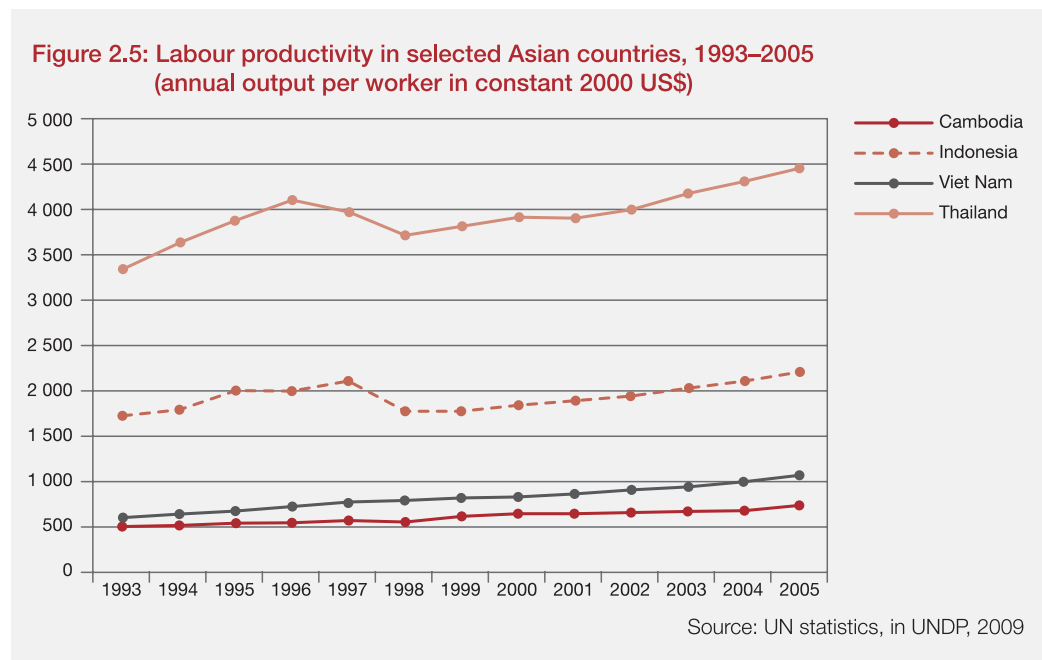
<sup>52</sup> GDS, 2003; JDI, 2007b.



## Productivity

Productivity in Cambodia is weak overall but varies greatly across factories. Figure 2.5 shows that despite recent advances, country-wide labour productivity is lower than in neighbouring countries, apart from Lao People's Democratic Republic.

Efficiency, as measured by comparing the time expended for constructing a pair of basic five-pocket denim jeans as a percentage of the international standard for time, was in 2005 only 35 per cent on average (92 minutes),<sup>53</sup> with some factories operating in the 60–80 per cent range, or 30–45 minutes (the normal high production rate in a well-run factory).



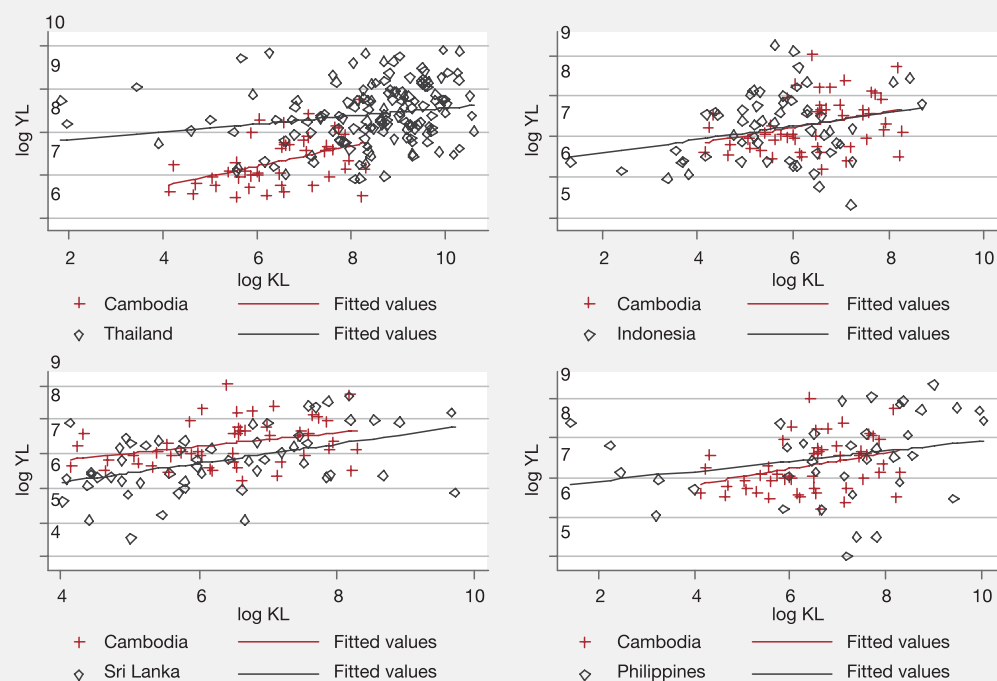
In the garment sector, where productivity constraints have long been evident, productivity deficits have been partially offset by the industry's continued low wages (second only to Bangladesh in Asia). This combined with its labour compliance record have kept the country relatively competitive, despite its comparatively lower productivity (vis-à-vis competitors like China and Viet Nam). An added concern going forward is the rate at which this situation is improving: between 2001 and 2005, Cambodia experienced the slowest rate of increase in labour productivity in manufacturing industries among ASEAN countries (for which data was available).

<sup>53</sup> That is only five pairs per worker per working day (8 hours), against 25 pairs per worker in China, 21 in India, 18 in Kenya, 14 in Uganda and 10 in Ethiopia (Global Development Solutions, 2003).

Several hypotheses may help explain the generally low productivity observed in Cambodian garment factories. These are:

- Poor mix of labour and capital inputs. Capital intensity in Cambodia is low. As figure 2.6 highlights, average capital input is less than that in other countries, even though, at similar levels of capital, labour productivity is similar to other countries (with the exception of capital). Although levels of employment do not seem to be the issue (in fact, indications from investment-climate research suggest that without other constraints, factory owners would be prepared to expand their workforce – sometimes by more than 10 per cent), the skill level of workers is low, with 55 per cent of the workforce having less than a sixth grade education. Poor individual productivity is somewhat offset by a typical employee's work year being significantly longer in Cambodia than in Viet Nam (2,836 hours compared with 2,174 hours), but this may come at the cost (to the individual) of quality of life and missed opportunities for skills upgrading.<sup>54</sup>

**Figure 2.6: Labour productivity versus capital intensity in the garment sector**



Note: These four charts plot value added per worker (log YL) against capital per worker (log KL) for four countries and Cambodia. Each chart includes the distribution of observations and the fitted value of a linear regression

Source: World Bank, 2009, annex E

<sup>54</sup> World Bank, 2009 and 2010.

- The garment sector's low utilization rate (57 per cent compared with 66 per cent across the general economy, according to the World Bank),<sup>55</sup> which is largely due to disruptions caused by both power outages (grid electricity supplies remain unreliable even in the capital city) and industrial action, such as strikes.
- Unionization in the industry is high, at close to 60 per cent; at the height of its pre-crisis success, there were some 450 unions active in around 300 (formal) factories.<sup>56</sup> In 2010, there were 45 strikes and 202,204 days lost, according to GMAC strike monitoring data. From an employer's perspective, strikes not only result in economic losses to the business but can also jeopardize relationships with buyers. In severe cases, factory employers have been known to decline orders for fear of not being able to guarantee delivery.
- Management constraints. Failure to control fabric quality before cutting, for example, can generate significant waste because defects are only detected at the end of the production line rather than at the beginning when it can be rectified. In addition, poor cost accounting and a lack of attention to time lost throughout the production line can also weaken overall management performance and productivity.

This is not to say productivity has not improved. In fact, between 2003 and 2007, Cambodia recorded impressive productivity gains of around 5 per cent per annum in its garment industry.<sup>57</sup> A major factor in this has been the improved technical training of shop floor staff and supervisors, which has typically been done in-house by factory managers as a means to improve efficiency of production and enhance quality assurance on final products.

Competitiveness also depends on the external environment. Increases in consumer prices in 2008, led by escalating global food and fuel prices, added new pressure to raise the minimum wage (which was temporarily raised in 2008 and permanently raised in September 2010). Rising labour turnover in the garment industry as workers sought new jobs with higher wages (inflation had eroded real wages in the factories) also added pressure to raise wages. In addition, the real effective exchange rate suffered a sharp appreciation during the early part of the crisis (in 2008 and

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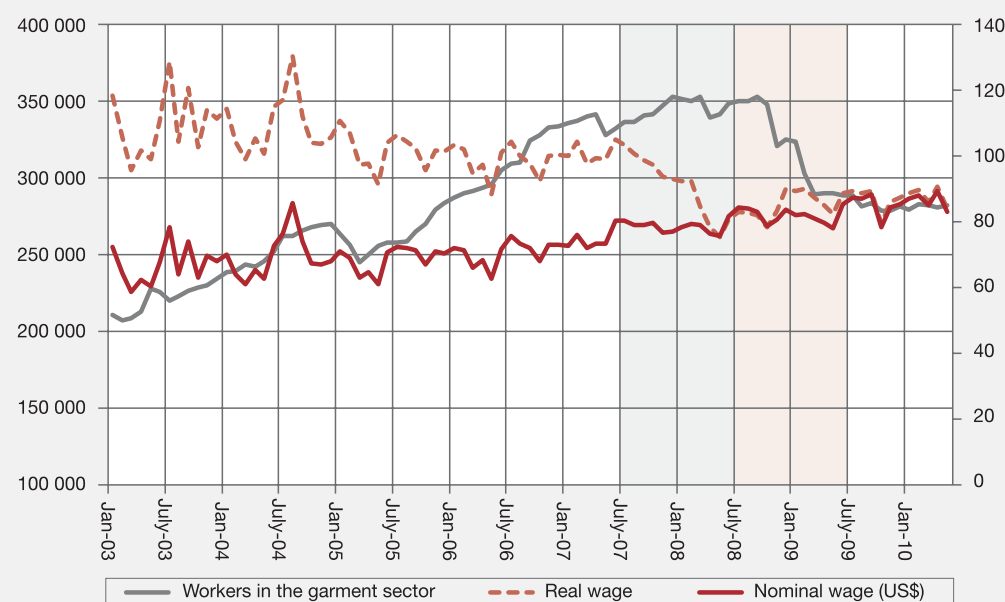
<sup>55</sup> World Bank, 2010.

<sup>56</sup> Unionization rates were calculated from the worker tracking study (chapter 4 of this report), while union numbers were taken from estimates of the Better Factories Cambodia programme.

<sup>57</sup> JDI, 2007b.

2009), thus eroding competitiveness against the country's Asian competitors. By 2010, this had reversed once again, which together with rebounding order volumes, created a generally more positive outlook for industry growth and competitiveness.

**Figure 2.7: Employment and wages in the garment sector**



Source: Ministry of Commerce, staff calculations

## 2.4 Impact of the global economic crisis<sup>58</sup>

The global economic crisis had a significant adverse impact on Cambodian enterprises, with widespread but typically varying impacts on profit levels in particular. The impact was quite generalized, with an adverse effect not only in the export sector but also in the informal economy (which, as in the case of the garment sector, is often closely linked to formal economic activities). The drivers of the impact were also broader than the decline in external demand: higher competition (and demand for lower prices and shorter lead times), reduced access to credit and falling domestic demand were also part of the equation. Survey findings also suggest that the crisis mainly affected the less-productive enterprises (everything else being equal). However, even at the height of the crisis, when short-term industry sentiment was negative, many factories maintained prior levels of investment and refrained from laying off staff to the degree possible. In this regard, it may be concluded that contrary to immediate

<sup>58</sup> See also Chapter 3, on enterprise-level impact.

expectations, the medium-term plans of employers were far less severely affected by the downturn. As the crisis receded in 2010, a World Bank survey revealed that despite being the hardest-hit economic sector by the turmoil, factory employers were generally no more pessimistic about their industry's future prospects than employers in other types of businesses.<sup>59</sup>

## 2.5 Sector-based initiatives to counteract the impact of the crisis

Lacking the fiscal space to replicate the stimulus packages invoked in other Asian countries, the Cambodian Government's response to the economic crisis was predictably limited and consisted mostly of small-scale and piecemeal efforts targeting specific at-risk groups. Considered the hardest hit, the garment sector was singled out for special assistance, with measures centring mostly on short-term tax relief and trade facilitation. These included temporary suspension of the 1 per cent advance profit tax (levied on garment factories' monthly turnover) as well as a short-term reduction in employer contributions to the National Social Security Fund (from 0.8 per cent to 0.5 per cent). Both measures were intended to give relief to garment factories already struggling with falling export orders and a tightening credit environment. In doing so, it was also hoped that the lay-off situation in the sector could be mollified, although the extent to which this ultimately helped remains unclear. The Government also implemented measures to reduce barriers and costs to trade, cut export management fees for garment factories (by 10 per cent) and simplify customs clearance procedures for returned goods. Assistance also extended to its workforce, through a \$6.5 million initiative to retrain laid-off factory workers and help smooth their transition back to work.<sup>60</sup>

After an unprecedented contraction in 2008 and 2009, Cambodia's economy is now well on the road to recovery. Although official data remains scarce, a number of indicators suggest an economic upturn is underway.<sup>61</sup> Cambodia has followed other Asian economies into a V-shaped recovery, with GDP growth in 2010 at 6.5 per cent and expected growth for 2011 at 8.7 per cent.<sup>62</sup>

However, economic growth is unlikely to return to the double-digit highs reached

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<sup>59</sup> World Bank, 2010a.

<sup>60</sup> These measures are discussed in further detail in chapter 5.

<sup>61</sup> This includes microfinance lending, which rose in 2010 amid rebounding consumption and small business activity, and the improving demand picture in key sectors, such as garments and tourism.

<sup>62</sup> GDP growth rates based on data in the *Cambodia Macroeconomic Outlook*, 2000-2011. New numbers included are EIC estimates.

in the immediate pre-crisis years. This is due not only to the uncertain state of the global recovery (Cambodia's economy still relies heavily on US and EU demand for its products) but also the various structural constraints the country faces in both its economy and labour market. Growth in the 2003–2007 period was heavily driven by the rapid expansion of the garment sectors, both of which are likely to have now plateaued. With growth still narrowly based and diversification and productivity remaining sluggish, the prospects for sustained high growth from the existing economic base seem limited. Improving the quality of human capital (workforce skills) in key sectors remains critical to any future advances, but these will not be realized in the short term.

## 2.6 Concluding remarks

The remarkable growth of the garment sector in Cambodia can be attributed to a number of factors, among them the special trade arrangements with the United States, the incentives given to foreign investors since the early 1990s, the niche created by compliance to labour standards and the evolution of the GMAC as a lobbying body. Most importantly, perhaps, has been the vast pool of cheap and available labour for the sector, the majority of which has been women who have become an integral feature of the garment sector and a symbolic part of the country's post-war industrialization.

In spite of its impressive growth record to date, the garment sector faces a range of structural problems that undermine its future potential. In particular, its low productivity, concentration on low value-added production and its lack of wider domestic links (to other sectors in the Cambodian economy) have given rise to concerns over the industry's sustainability in the post-crisis, post-quota global environment. The economic downturn exposed the acute vulnerability of garment manufacturing to shocks in the external economy as well as of a workforce heavily reliant on the sector for wage employment and income generation.

Even in the earlier high-growth context (2001–2007), too few adequate jobs were created, and this helped push up youth unemployment (3.3 per cent, according to the 2008 census), exacerbate income inequality and constrain women in vulnerable employment. This situation casts doubt over the quality of growth provided by the country's current development model and raises questions in policy circles over

how growth can be better tailored towards employment outcomes as well as a more equitable distribution of wealth.<sup>63</sup> While it is true that the garment sector has been a critical spur to growth and employment creation for the past decade and a half, it is also increasingly clear that this sector alone will be insufficient in the coming years to provide the jobs needed for Cambodia's fast-growing working-age population.

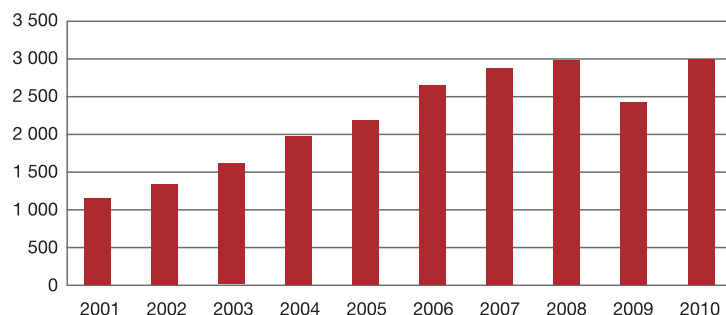
The overall policy outlook in Cambodia remains mixed, despite the recovery. As the economy picked up in early 2011, the Government started to withdraw the fiscal stimulus it introduced in response to the downturn in 2008 and 2009. Fiscal policy, however, will remain broadly expansionary, with government expenditure likely to rise further on 2010 levels. With a low tax base and limited reforms to address this, the Government intends to tighten collection procedures for the existing base, hoping this will help reduce the creeping budget deficit. With limited control over monetary policy (the economy is highly dollarized), policy-makers will struggle to keep inflation under control in the short and medium terms.

### Box 2.1

#### Industry update 2011: Strong recovery, but employment still lagging

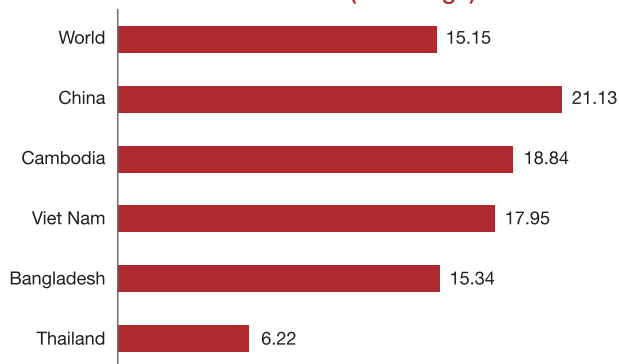
After a sharp slowdown amid the global economic crisis, the garment sector in Cambodia started to rebound in 2010, with a return to workforce growth and a stabilization of factory numbers. Thanks to recovering external demand for garments (particularly in the latter half of the year), production expanded robustly in 2010, growing 26 per cent on the previous year. This allowed production to reach pre-crisis levels from a now-smaller number of factories (figure 2.8). The strong recovery in production was also evident in US import data, which although starting from a low base showed impressive growth in Cambodian apparel imports in 2010 (figure 2.9).

**Figure 2.8: Cambodian garment exports, 2001–2010 (US\$ million)<sup>1</sup>**



<sup>63</sup> The data as well as analysis are from the report *Labour and social trends in Cambodia 2010* (NIS, 2010). As noted in this report, vulnerable employment is measured as a sum of "own-account workers" and "unpaid family workers" and is a proxy for informal employment.

**Figure 2.9: US garment imports, by country from December 2009 to December 2010 (% change)<sup>2</sup>**



Although production recovered strongly, the picture regarding employment has been less impressive. Despite the creation of some 37,000 new jobs in 2010 in the garment sector, an expansion of 13.3 per cent from a year earlier, the new total of 319,383 remained more than 30,000 short of pre-crisis highs.<sup>3</sup> Given the lower number of factories now in operation, it remains unclear both whether employment will return to pre-crisis levels in 2011 and the extent to which further job growth can proceed without further reforms to diversify the garment product mix, manufacturing capabilities (for more intricate, design-intensive and advanced garment products) and export markets served by Cambodian factories.

In terms of exporting, the Cambodian garment sector had a strong first half 2011. A large part of the success is because the country-of-origin requirements were eased for duty-free exports to the European Union. The United States still represents the major destination for exports; but exports increased to the United States by only 17 per cent in 2011 while exports to the European Union increased by 54 per cent, as of July 2011. The impressive exports numbers, however, mask stagnant or declining profits of the factories because of rising costs of inputs, particularly cotton.

<sup>1</sup> Ministry of Commerce, 2011.

<sup>2</sup> Ministry of Commerce, 2011.

<sup>3</sup> BFC data shows a workforce peak of 353,014 in December 2007.





Enterprise-level impact:  
Responding to the economic crisis  
and future perceptions

3

## 3.1 Introduction

Broadly speaking, the garment sector can be characterized by two main types of enterprise: formal exporting factories and non-exporting, often informal factories, the latter of which are typically subcontractors. Exporters, which form the bulk of garment producers in the country, are subject to a range of special governance arrangements that, having first emerged in the 1990s, have helped to generate a level of organization, regulatory oversight and legal compliance that is seldom seen in other sectors. For example, all factories operating for export must register with the main employers' organization, GMAC. To obtain an export license, factories must submit themselves to regular monitoring of labour standards, as overseen by the ILO's Better Factories Cambodia programme.

Unlike exporting factories, non-export factories do not have to join GMAC and are not subject to mandatory labour monitoring (although they still have to register their operations with the Government). Thus, far less is known about the structure, operations and working conditions of these enterprises, not to mention how many there actually are in the country (in reality, many fail to register with the Government). This is further exacerbated by their often complicated ownership patterns and tendency to open, close and relocate regularly.<sup>64</sup> Most subcontractors are believed to be locally owned, unlike formal exporters, with smaller workforces than in the export sector. Officials also believe that non-compliance with basic labour standards is far more prevalent in these factories, a factor that some think could eventually erode Cambodia's hard-earned reputation as an "ethical" producer in the global garment sector. There have been discussions recently within the Government on how to better regulate subcontracting arrangements and to enhance these factories' respect of the labour law and new regulations to this effect were issued in September 2011.

Both exporting and non-exporting enterprises, however, are dependent on external demand – either directly or indirectly through subcontracting mechanisms (though there may be some non-exporting factories that also cater to the small local market). Additionally, most garment factories are heavily dependent on imported raw materials. These make them especially vulnerable to various kinds of external shocks, as revealed by the recent economic crisis. It is clear that the recent economic

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<sup>64</sup> These movements are often in line with export-sector demand. Both sections of the industry are interlinked, with non-export factories often relying on the export factories for subcontracting orders. Consequently, while not directly reliant on overseas buyers, demand in these factories often rises and falls in line with global consumer trends.

crisis that hit Cambodia's garment exports had a serious negative impact on garment factories (at least some), which till then were quite profitable. Several closed down and cut back on their employment levels. Overall, there is no comprehensive data and information on which types of factories were affected more than others and in what way and what their coping mechanisms were. The ILO conducted an enterprise-level survey in 2009,<sup>65</sup> which partially fills that gap; the survey probed the structure of the garment sector, responses to the crisis and employers' longer-term outlook, the findings of which form the basis of this chapter (complemented with data from secondary sources where required).

## 3.2 The enterprise survey

In 2009, the ILO commissioned an enterprise survey to study the impact and response of Cambodian garment factories to the economic downturn. The study was conducted by BDLINK Cambodia Ltd and the Cambodian Federation of Employers and Business Associations (CAMFEBA).

The primary objectives of the survey:

- provide a brief overview of garment factory operations in Cambodia;
- analyse workforce composition, labour costs and other costs associated with production;
- examine the situation regarding industrial relations, strikes and protests;
- assess the impact of the global economic slowdown on factory operations;
- identify measures taken by factories in response to this slowdown; and
- better understand the future plans of the factories.

### *Survey methodology and challenges*

The survey covered 66 garment factories (thus 66 owners or managers) in and around Phnom Penh (where the bulk of production occurs), 56 of which were direct exporters and hence, GMAC members, and ten of which were non-exporters (non-GMAC members). Based on February 2010 figures, the export factories represent approximately 22 per cent of all factories registered with GMAC.<sup>66</sup> The ten non-GMAC factories were registered with the Ministry of Labour and Vocational Training

<sup>65</sup> ILO and CAMFEBA, 2010.

<sup>66</sup> By Cambodian law, if a factory wants to obtain an export license, it must be a member of GMAC. Hence, GMAC membership is a good indicator of the size of the export sector for garments in Cambodia.

(MOLVT) and represent around 11 per cent of non-member factories registered.<sup>67</sup>

The factories were identified through data sources provided by GMAC (membership list) and the Department of Labour Inspection at the MOLVT. In both cases, all known or registered factories were contacted for an interview; hence, the resultant sample size reflects the factories that were available and willing to participate in the study but indicates a certain bias towards better-performing factories that were less likely to refuse an interview. The sample size for non-GMAC factories (11 per cent of the total) was considered less than ideal, although still acceptable in terms of indicative representation. The questionnaire was first trialled during a training session with the research team to ensure that the questions were in line with the overall goals of the study. Interviews were then conducted over a two-month period, with findings then entered into a database for analysis.

The survey encountered a number of challenges. Although considerable efforts were made to arrange face-to-face interviews with factory owners or managers (employers), there were particular difficulties in reaching those in the non-GMAC factories. Among those who were reached, few were openly willing to discuss their operations – with the majority declining to be interviewed. Consequently, the team was only able to include ten factories from this group in the overall sample.

Based on their prior experience in conducting research on the garment sector, the research team noted that the factories that participated in the survey tended to be among the industry's “better performers” in terms of both the efficiency of their operations and their labour standards. Also, at the time of the survey, many of the respondent factories were still busy with holiday-period export orders, despite the wider economic slump in the sector.

Some employers were reluctant to provide information on “sensitive” issues, such as revenues, expenses and costs of production (particularly raw materials). With the latter point, this may have been more an issue that raw-material purchasing is typically managed by head offices outside Cambodia, leaving managers in the country unaware of the financial details. More generally, however, the reluctance to divulge this type of information also stems from fears over its misuse or misappropriation. To allay such fears, the research team made every effort to ensure that respondents

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<sup>67</sup> Based on the MOLVT list of garment factories, the survey team estimated that there were around 92 non-GMAC factories (with appropriate contact phone numbers) registered with MOLVT in November 2009.

were comfortable and understood the objectives of the survey and guaranteed their confidentiality in the final report.

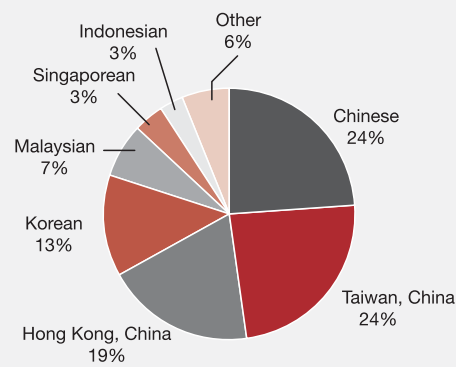
### 3.3 Findings from the enterprise survey

#### *Nature and structure of the garment industry*

The following notes the main findings of the survey in relation to the structure and characteristics of garment factories, most of which are generally well known from the existing literature.

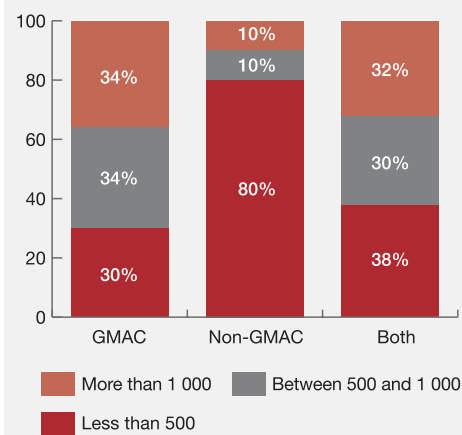
- Factory ownership is dominated by East Asian ethnic Chinese interests (figure 3.1 shows ownership by different nationalities), with less than one in seven factories operating as a joint venture between Cambodians and overseas investors.<sup>68</sup> This type of foreign investment also implies that major managerial decisions are made outside Cambodia.
- There is considerable variation in factory size across the industry: the median workforce size is 700 and the mean workforce size is 920.<sup>69</sup> As figure 3.2 shows, however, the GMAC factories are distributed quite evenly across different size groups, with the largest numbers at more than 1,000 employees. The non-GMAC factories are smaller in size, with 80 per cent of them having fewer than 500 employees.

**Figure 3.1: Nationality of factory owner**



Source: ILO/CAMFEBA, 2010

**Figure 3.2: Workforce size, by factory type**



Source: ILO/CAMFEBA, 2010

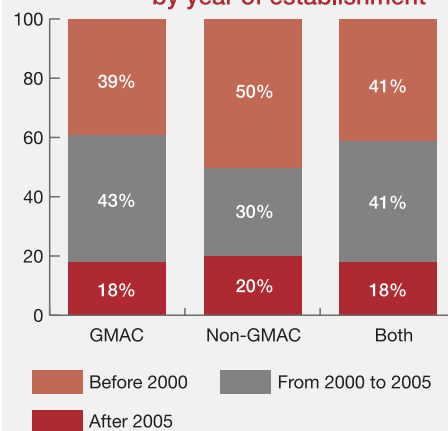
<sup>68</sup> ILO, 2010: 12.

<sup>69</sup> There is, however, considerable range between large and small factories in Cambodia, thus limiting the usefulness of the mean figure.



- Some 90 per cent of workers across the industry (non-GMAC factories included) are female and, according to employers, only a fraction – just 2.8 per cent – is a temporary worker. Working hours are long but arguably not excessive – nine hours per day, six days per week on average. Salaries appear to range quite widely, with an average of \$84 per month, including overtime, benefits and bonuses.
- More than 80 per cent have been operating in the country for less than ten years and are considered relatively young (figure 3.3).
- While Cambodians fill all semi-skilled and unskilled production positions, managerial positions, including mid-level roles, usually rely on foreigners (and predominantly Chinese). Cambodians can be found in supervisory roles, but factory employers have noted that it is often difficult to find suitably qualified local candidates for technical and middle-management jobs.
- The vast majority (85 per cent) of factories rent rather than own their production facilities. This may suggest a predisposition for not establishing long-term roots in the country.<sup>70</sup> Such trends are not unusual in the garment sector, which has a reputation globally for being “footloose”. Moving from place to place in search of the best labour costs and trade and investment incentives is a hallmark of this industry globally, and indeed it was the favourability of these factors in Cambodia in the mid-1990s that spurred garment investors to locate here (often to the loss of more established producing countries).
- Export factories produce predominantly for the US and EU markets, which together purchase more than 90 per cent of the sector’s output. As a leading global supplier of apparel (with a stated and well-publicized commitment towards basic labour standards and ethical treatment of workers), Cambodia has retained long-

**Figure 3.3: Garment factories surveyed, by year of establishment**



Source: ILO/CAMFEBA, 2010

<sup>70</sup> This could partly be explained by the restrictions on foreign ownership of land, which does not allow foreign firms to set up a factory on their own land.

standing partnerships with large designer and high-street retailers, such as GAP, Levi's, Adidas and H&M, which export both to US and EU markets. However, the recent economic crisis illustrated the weaknesses in the sector's narrow market focus and heightened calls for enterprises to diversify both their export markets and product mix. Long term, this will be crucial in ensuring the sector's continued growth and resilience to external shocks.

- The enterprises usually specialize in one or two product lines from a narrow range of items, including T-shirts, jeans, pants, sportswear, underwear and pyjamas. These goods are usually basic in design and provide only limited added value for the manufacturer. As it stands currently, the industry does not have widespread capacity to produce more complex, design-intensive garments, which although usually ordered in smaller batches, tend to command higher prices and profit margins.

### *The crisis and enterprise-level responses*

As noted earlier, the garment sector's specific vulnerability to the crisis stemmed largely from its demand-side characteristics and, specifically, its export focus. During the downturn, the exports were the main channel through which the contagion from the crisis in Europe and the United States spread to Cambodia and its garment factories. The sector's foreign ownership was also a source of added vulnerability for enterprises because many owners were financing operations from funds located in recession-hit developed economies (mostly in Asia). Within the country, access to short-term lines of credit was also important, providing enterprises with a vital source of financing for working capital. With this being already expensive and problematic to obtain in Cambodia, it is little surprise that during the downturn many factories experienced difficulties in covering day-to-day operational costs, particularly in light of falling demand.

Cambodian factories also operate in a highly competitive global market and one in which without the country's low wages and "labour-standards niche", investors would move to other low-cost producers in Asia and beyond. Even before the crisis, Cambodian producers were grappling with pressures from international buyers to reduce prices, shorten lead times and boost flexibility in both orders and product line – pressures that only intensified during the global downturn. Importantly, factories also endured weakening bargaining power regarding prices amid the crisis, a consequence that can be directly attributed to the new competitive pressures in the market. In addition, a disruption in supply chain dynamics arose during the

crisis, with policy-makers arguing that Cambodia was losing out because buyers were diverting orders to cheaper and less labour-compliant countries, like Bangladesh and China.

### *Impacts at the enterprise level*

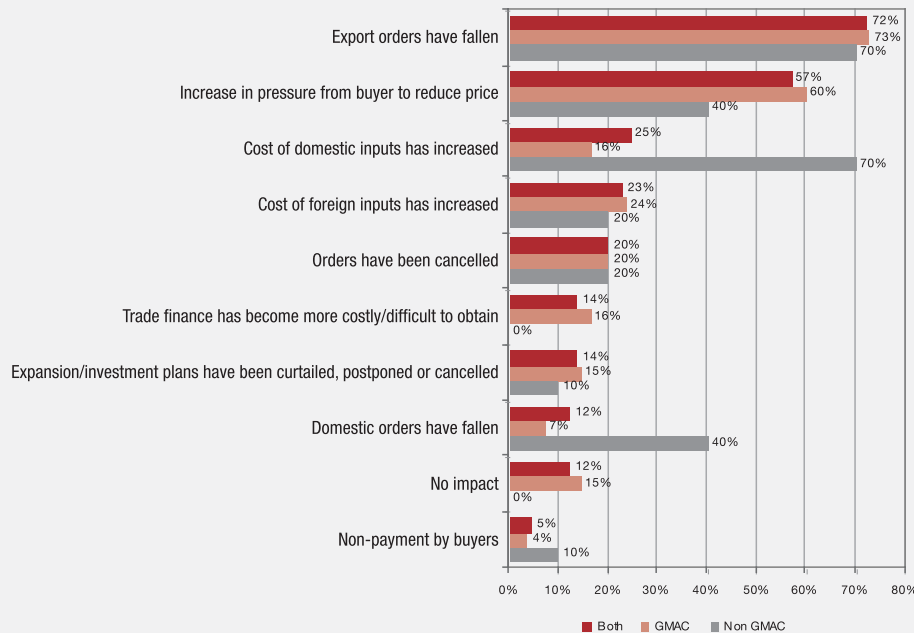
Despite difficulties in securing the cooperation of non-exporting factories, the survey revealed important insights into the common and differential impacts of the crisis across the sector. It also brought out a number of issues on how enterprises and the sector as a whole can best adapt to the new economic context and ensure continued growth and sustainability in the future.

Some 88 per cent of factories in the survey were adversely affected by the downturn in one way or another, most commonly as a result of diminished export orders (or sales orders, for subcontracting factories), heightened price pressure from buyers and increased costs of inputs (figure 3.4). Looking at the non-export factories alone, however, this figure is 100 per cent (all ten participating in the survey), which suggests that far from being insulated by the fact they don't export directly, they are actually even more vulnerable to external demand shocks than the formal exporters. Logically, this makes sense because the bulk of these enterprises sell exclusively to export factories, thus tying their fortunes firmly to the formal economy. However, their vulnerability may also stem from lack of a diversified customer bases, something that is common across the sector but likely to be more binding in the case of smaller factories reliant on subcontracting orders.

Non-exporting factories also appear to have suffered more severely from rising domestic input costs during the downturn, a comparably greater percentage of them reporting this as a problem than GMAC factories. This might be explained by the lack of external sourcing options among those factories, which are typically smaller and have fewer international links than their GMAC counterparts. In addition, the informal, often transitory nature of enterprises in this subsector may also preclude the establishment of non-domestic sourcing partners, which often require formal contracts and a level of trust that might well be lacking in these circumstances.

The adverse impact of the crisis was also reflected in declining financial fortunes in a large number of garment factories. Revenue contractions varied widely across the sector, from as little as 5 per cent among the best-performing enterprises to as



**Figure 3.4: Adverse impacts on garment factories**

Source: ILO/CAMFEBA, 2010

much as 75 per cent in those hardest hit. This differential picture for the industry as a whole raises important questions on why some factories managed to escape the crisis relatively unscathed and, within this, consideration of what elements in their business were most influential towards that resilience. Identifying such elements will be important as Cambodia enters the post-crisis phase because it will help researchers and policy-makers better understand what enables enterprises to withstand external shocks and thus be better equipped to advise on the development of more sustainable business and industrial growth models.

As would be expected in line with revenues, profits were also negatively affected during the crisis. This is confirmed by World Bank research,<sup>71</sup> which found that 94 per cent of garment factories (in its survey) reported a decrease in profits between September 2008 and a year later, with an average net decline of 30 per cent. This reaffirms other evidence in highlighting garment manufacturing as one of the hardest-hit sectors in the economy as well as in attributing much of it to the twin – and interlinked – effects of reduced external demand and increased global competition.

The experiences of unaffected factories provide important insights into the best basis

<sup>71</sup> World Bank, 2010a: 5.

for crisis resilience in the garment sector. Unaffected factories account for just 12 per cent of the ILO survey sample, and these encompass GMAC members (formal exporters) solely. For the most part, these enterprises are also larger than the affected factories, with workforces typically exceeding 1,000 (the industry average is 920). These enterprises also appear to have had fewer difficulties both in finding appropriate skilled labour and in managing industrial relations on the factory floor.<sup>72</sup> While the importance of the former is contentious (as discussed later in this section), the latter finding demonstrates a clear advantage: unaffected factories had less fractious conditions, with fewer than average problems with both labour compliance and industrial disputes. This ultimately means fewer stoppages and greater efficiency of their operations.

Unaffected factories also tended to enjoy strong, positive relationships with external buyers, a feature that seems to have been important in enabling them to retain orders (sometimes at reduced volumes) despite an overall decline in global demand.<sup>73</sup> Consequently, factories in this situation seem to have been comparably better equipped to insulate themselves from the worst of the economic crisis and, in turn, less prone to the types of harsh workforce adjustments exercised in other factories. Through this and other factors, unaffected factories also sustained generally more favourable sales and revenue positions than many of their competitors. Given the extent of Cambodia's economic woes in 2009, with garment exports tumbling as much as 20 per cent, this is both impressive and instructive.

Concerns over rising expenses had been prevalent in the industry for a number of years; however, during the crisis the situation abated somewhat. Before the crisis, Cambodia had experienced several consecutive years of high inflation, driven largely by spiralling food and fuel prices that started in late 2007.<sup>74</sup> From an average of 3.9 per cent between December 2002 and 2006, year-on-year consumer price inflation increased to 25.7 per cent in May 2008.<sup>75</sup> Although core inflation (which excludes food and commodity prices) remained far lower during this time, it still led to marked increases in production costs (typically the largest component of total expenses) for many garment factories. In the latter half of 2008, these pressures eased as the

<sup>72</sup> The extent to which availability of skilled labour is a major advantage in the Cambodian context is debatable, most notably because of the overwhelmingly low-skilled nature of garment production in the country. Indeed, recent research conducted by UNDP found that in the garment sector, skills – or rather, lack thereof – were not considered by employers to be a major constraint to assembly businesses (UNDP, 2009: 35).

<sup>73</sup> This was also accompanied by an apparent consolidation of industry orders towards high-volume, low-cost producers, such as in Bangladesh and China.

<sup>74</sup> ADB estimates (2009) suggest rising food prices accounted for over 80 per cent of inflation between 2002 and 2008.

<sup>75</sup> Ginting and Bird, 2009.

global recession took hold in the country. Rather than being appeased, many factory managers were instead confronted with new and equally worrying concerns about falling demand and revenues. Although up to a quarter of factories saw expenses fall, it is likely that far greater numbers were hit by collapsing orders and increased price pressures from global buyers.

According to the survey, nearly two thirds of the responding garment factory employers also thought it necessary to cut prices during the downturn to retain orders and prevent loss of market share to local and foreign competitors. To a large extent, this reflects the vulnerability of factories in the competitive context of global garment manufacturing and the fact that most – in Cambodia and elsewhere – find themselves at the behest of global buyers who can dictate terms for both price and product.<sup>76</sup> Because this is a structural issue inherent in the global garment trade, the direct and knock-on problems it causes for Cambodian enterprises appear binding, at least in the short term. Despite an upturn in industry fortunes in the first half of 2010, particularly in terms of export orders, prices remained on average 10–15 per cent lower than they were in early 2009.<sup>77</sup> Consequently, the prospects for concomitant recovery in job growth in the sector remain in doubt.

### *Impact of enterprise decisions on workers*<sup>78</sup>

The survey revealed that many enterprises made significant workforce adjustments during the downturn, ranging from reductions in standard and overtime working hours to workforce suspensions and outright retrenchment. These adjustments occurred predominantly in the export factories, and it was production workers more than managers and administrative staff most affected.<sup>79</sup> This is to be expected to an extent because production workers form the bulk of factory employees as well as the portion of the workforce whose positions are most sensitive to the external demand environment. However, it also aptly reflects a trend often observed during economic shocks – that the burdens created fall most heavily on those least able to cope.

Driven by fear that factories may close down and that managers may not comply with their legal obligations and instead leave workers without severance and indemnity

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<sup>76</sup> This is particularly true at the cut-make-trim stage of production, where Cambodian firms are largely concentrated.

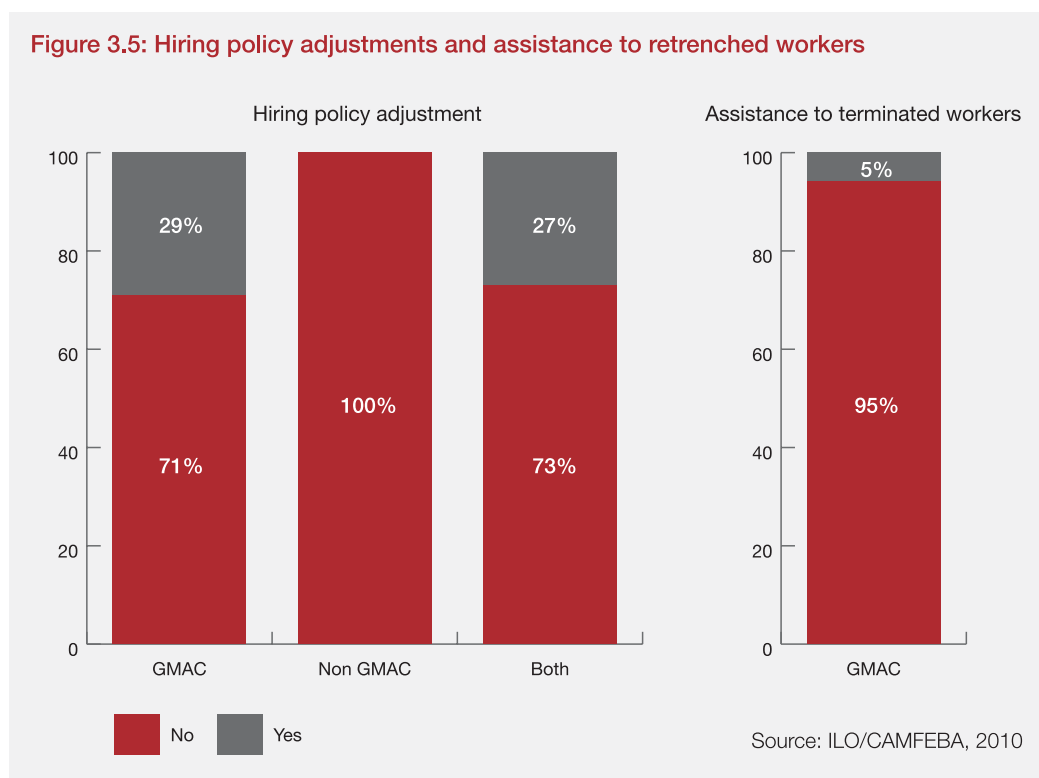
<sup>77</sup> Loo, in Marks, 2009.

<sup>78</sup> Although the worker perspective of these measures is explored in greater detail in chapter 4, the focus here is on the managerial side of the responses and their perceived or actual impacts on workers.

<sup>79</sup> This reflects a wider trend in the enterprise sector in Cambodia; see World Bank, 2010a, for example.

payments, trade unions during the crisis requested the Government establish a special fund to cover workers' payments in case of factory insolvency. Many workers more readily agreed to short-term contracts as a means to shield themselves against being left empty-handed if a factory went bankrupt and to compensate for diminished earnings with severance payments.

The survey findings indicate that just less than a third of factories altered their recruitment practices in response to the new economic context. Typically, these changes have taken the form of tightened recruitment procedures and non-renewal of contracts on expiry (figure 3.5).<sup>80</sup>

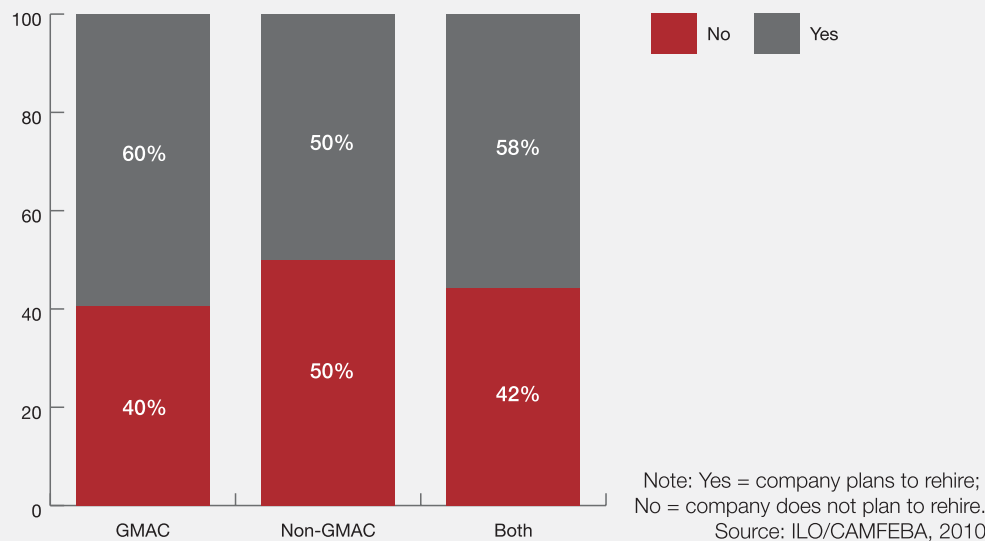


At the time the survey was conducted in late 2009 and early 2010, most of the employers planning to rehire intended to do so in the coming months (figure 3.6). Aside from the temporary increase in (short-term) recruitment during the Christmas holiday season (2009), more than a third of employers reported that they would start

<sup>80</sup> This latter condition is somewhat contradicted by corresponding worker-level research, which suggests that the majority of the laid off workers were actually retrenched before the end of their contract (see chapter 4). In addition, indications from other sources point to concerns over the commitment of (some) firms to good-faith application of the labour law. In particular, alleged cases have arisen whereby employers have been accused of using the economic crisis as a pretext to retrench fixed-term and undetermined duration contract staff and re-hire workers on shorter-term, less secure contracts (which entail fewer legal obligations for employers). Although not illegal, such practices represent a concern in an industry that has not only built a reputation on sound labour standards and decent work but has also a vibrant and proactive union movement that is prone to speak out against perceived injustices.

to hire new or previously laid-off staff within the next three to nine months. Another fifth said they would rehire within nine to 12 months or in stages over the next 12 months (November 2009 to November 2010). Together, this contributed to an expected gain in net employment among these factories of around 20 per cent.<sup>81</sup>

**Figure 3.6: Recruitment plans in the coming 12 months, November 2009–November 2010**



Some 20 per cent of employers believed that the lack of skilled labour can be addressed by offering (better) training to Cambodian employees. Some employers even expressed confidence in the ability of Cambodian graduates to eventually replace the majority of foreign supervisors in the sector. Owing to the stigma that remains among educated Cambodians about the garment sector, this is likely to take some time.

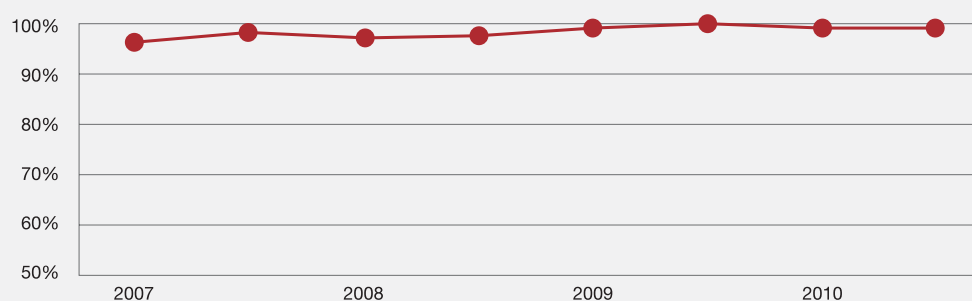
The survey findings also indicate that despite considerable new pressures amid the economic crisis, earlier industry progress in improving working conditions remained unaffected. Data from the Better Factories Cambodia (BFC) programme, which monitors factory compliance, validate this finding. Compliance with basic working conditions remained relatively high during the crisis. According to the BFC synthesis reports,<sup>82</sup> most working conditions and related rights withstood the new pressures with noteworthy resilience, especially those relating to minimum wage payment and

<sup>81</sup> Forecasts of workforce increases varied widely among factories, from as little as 5 per cent to 68 per cent (ILO/CAMFEBA, 2010).

<sup>82</sup> For ILO Better Factories Cambodia synthesis reports see: [www.betterfactories.org](http://www.betterfactories.org)

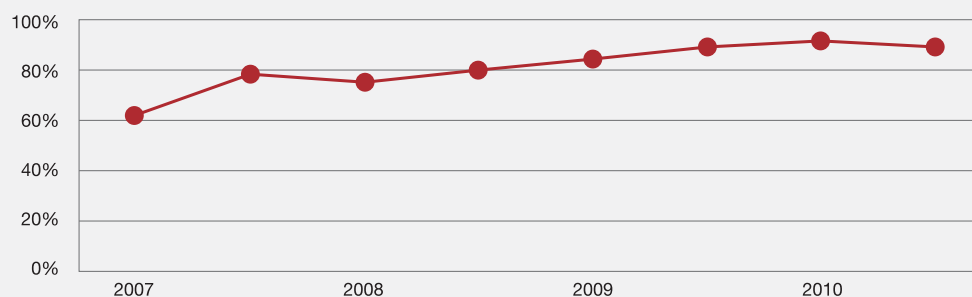
voluntary overtime work (figures 3.7 and 3.8).<sup>83</sup> Additionally, there were no or rare incidences of forced and child labour. However, the BFC reports also show that maternity leave was a problem area, and during the 2007–2010 period, compliance with maternity leave payments was the most heavily impacted labour standard. From the April 2008 synthesis report to the November 2010 edition, compliance dropped from 90 per cent to 55 per cent (figure 3.9).

**Figure 3.7: Factory compliance with minimum wage, 2007–2010**



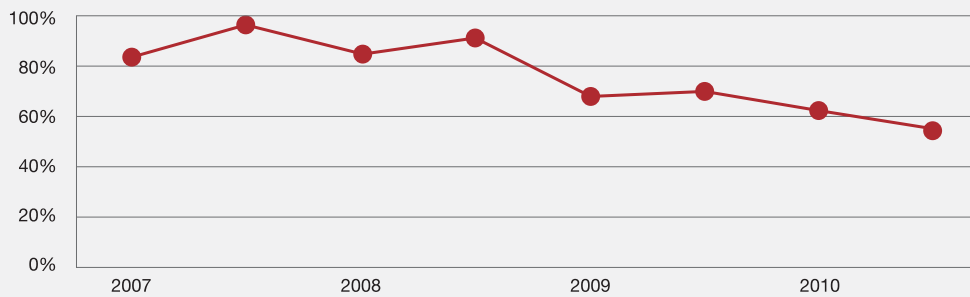
Source: Better Factories Cambodia, 2010

**Figure 3.8: Factory compliance with voluntary overtime, 2007–2010**



Source: Better Factories Cambodia, 2010

<sup>83</sup> The BFC reports also show that some improvements to labour standards were made during this time, too: installation of needle guards on sewing machines, for example, rose from 50 per cent to 73 per cent, while compliance with voluntary overtime also improved. The reason for the latter increase is probably two-fold: amid widespread industry cutbacks that led to reduced overtime and real incomes, it is likely that many struggling workers were actually more willing to agree with overtime offers (so as to secure as much income as they could in case of future unemployment), thus allowing employers to comply more easily with the requirements of voluntary overtime.

**Figure 3.9: Factory compliance with maternity provisions, 2007–2010**

Source: Better Factories Cambodia, 2010

Some of the most serious abuses of labour rights remained as they had been prior to the crisis. Similarly, discrimination and freedom of association findings remained close to their pre-crisis levels. Overall, the BFC synthesis reports show that workers' rights and working conditions in the garment sector withstood the test of the economic crisis fairly well, with only a few areas in which backsliding from earlier advances (made during the early and mid-2000s) was evident.

### *Industrial relations and working conditions*

Although industrial relations have often been characterized by high levels of friction, data suggest there was no noticeable deterioration in these conditions during the economic crisis.<sup>84</sup> After increasing by 31 per cent between 2007 and 2008,<sup>85</sup> strike numbers declined by 44 per cent in 2009 and 22 per cent in 2010 (figure 3.10).<sup>86</sup>



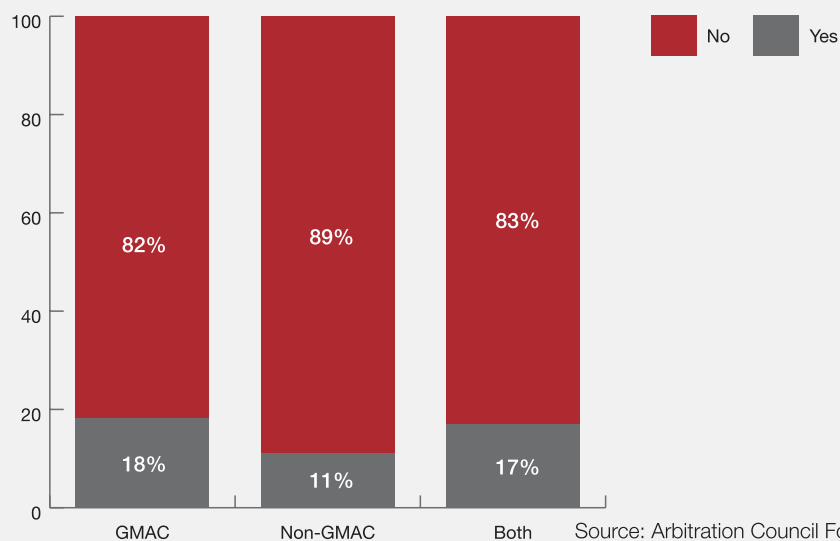
According to the enterprise survey findings, only a minority of factories (17 per cent) reported experiencing industrial disputes in the year ending September 2009 (figure 3.11), while among those that did occur, only a quarter were said to be linked to the economic crisis (figure 3.12).

<sup>84</sup> Arbitration Council Foundation, 2010.

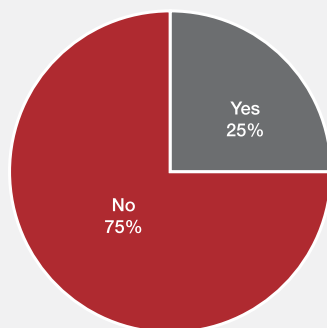
<sup>85</sup> This large jump in strikes is attributed to the Free Trade Union of Workers general strike in March 2008 over wages and inflation, affecting some 26 factories for up to two days.

<sup>86</sup> During the economic crisis, an important function was played by the Arbitration Council, which was established in 2003 to resolve collective labour disputes. Since then, the number of cases dealt with by the body has progressively increased in tandem with the continued growth of the industry. Some 85 per cent of all cases are from the garment sector. As of December 2010, the Council had received a total of 978 cases (since its inception) and recorded a 70 per cent success rate in dealing with disputes. During the economic crisis, the number of cases continued to climb, peaking at 180 in 2009. In 2010, as the economy started to rebound and garment factories started to recover, this figure fell to 145.

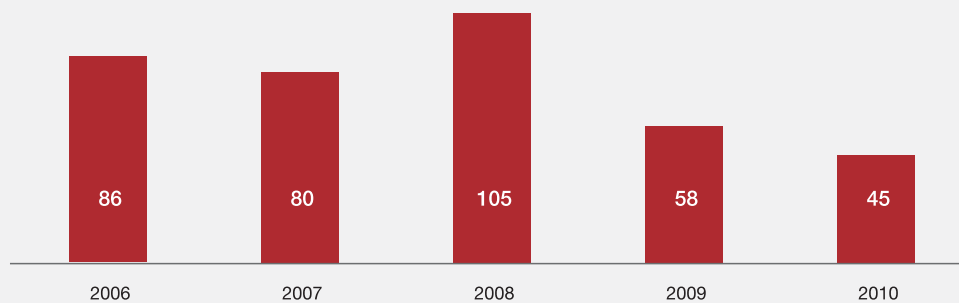
**Figure 3.10: Number of strikes in the garment sector, 2006–2010**



**Figure 3.11: Number of factories experiencing an industrial dispute, September 2008–September 2009**



**Figure 3.12: Disputes related to the economic crisis**





One possible explanation for the decline in strikes, and one observed by economists studying the crisis in 2008, was that this reflected a general union sentiment during the time to avoid confrontation, done primarily out of fear of exacerbating an already difficult situation for workers (by striking).<sup>87</sup> At the same time, however, it may also be the case that managers misreported industrial disputes in their survey responses, either in terms of their absolute numbers or their causes (or both). Whether or not this was deliberate is impossible to tell because conscious misreporting can easily be concealed by the reasonable claim that this is a subjective issue.

The most common causes of strikes, according to surveyed employers, were differences with staff over compensation issues as well as over their respective interpretations of the labour law. In their opinion, neither was related to the crisis; although in the absence of a strict definition of what constitutes “caused by the crisis”, this remains highly subjective. Results may also be skewed by asymmetric information and misreporting: On one hand, disputes may have been identified as personal disputes among workers with little knowledge of the wider crisis and its causes; while on the other it may also have been preferable for the surveyed employers to characterize disputes as personal ones so as to retain confidentiality over their financial predicament.

### *Employers’ perceptions*

The survey sought to uncover details of employers’ plans to hire new or previously retrenched staff in the post-crisis period. The intent was to produce a snapshot of industry sentiment regarding employment and an indicative view of how the industry might develop in the coming years. On the whole, the picture appears mixed: While a slight majority (58 per cent) of the surveyed employers (both exporting and non-exporting factories) said they would hire staff in 2010 (a positive sign, perhaps, that the sector will resume a significant role in job creation), this also leaves a significant proportion with no intention to take on new staff.

Relatively few factories were expecting further workforce contractions in 2010. Just five surveyed employers indicated they would be making further staff cuts; of them, however, the net loss expected was quite high, at 27 per cent of the workforce.

When it comes to expansion plans, the picture looks far less optimistic. Among the surveyed employers, only 10 per cent reported an intention to expand their

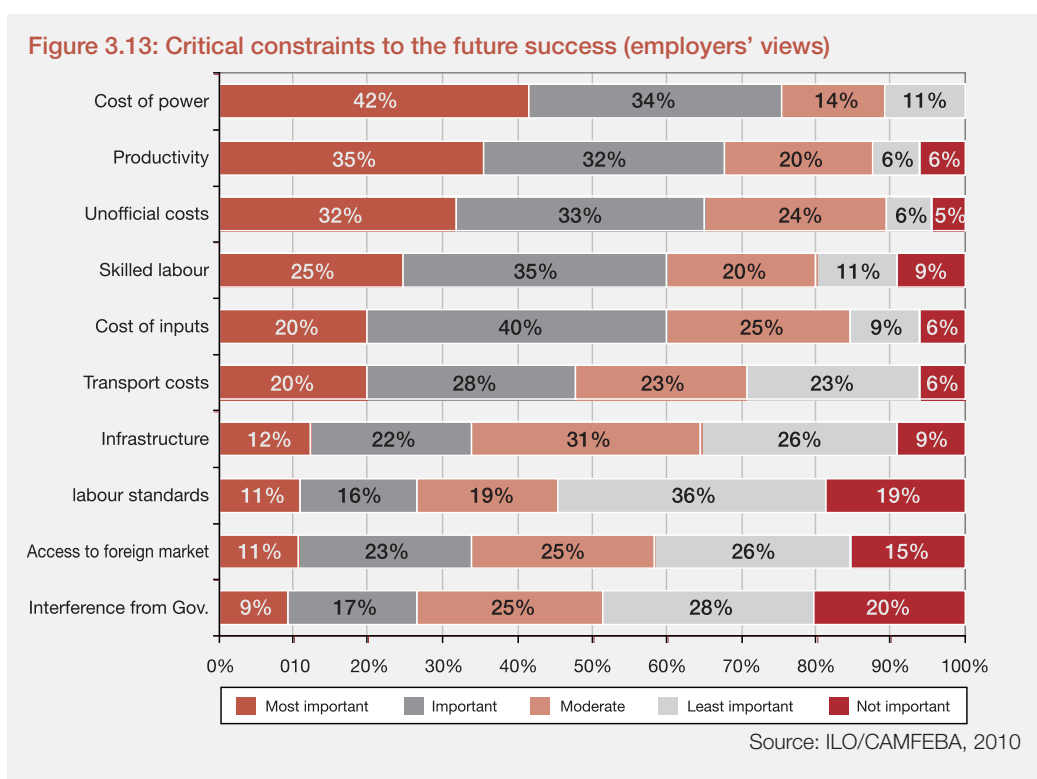
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<sup>87</sup> See, for example, ILO/CIDS, 2009.

businesses in 2010, with another 11 per cent planning to expand in the next three to five years. Perhaps most worrying, some 70 per cent had no plans to expand their businesses in the foreseeable future. This reflects a broader trend across the private sector, which suffered a sharp decline in optimism during the economic downturn.<sup>88</sup> Although employers could indeed be forgiven for being particularly pessimistic when questioned so soon after the crisis, the extent and prevalence of this sentiment may nevertheless be a concern to policy-makers in the country.

### *Constraints to industry growth: Employers' perceptions*

Constraints to growth in the garment sector have been well known for some time and have not changed since the economic downturn. Still, the crisis experience should serve as a watershed for policy-makers in terms of demonstrating the human and economic costs of these weaknesses and how increasingly difficult they make it for Cambodia to compete in the cut-throat industry of global garment manufacturing. The enterprise survey probed the factors that constrain the growth of the garment sector, as perceived by the employers (figure 3.13).



<sup>88</sup> World Bank, 2010.

More than three quarters of the surveyed factory employers noted the high cost of power, particularly electricity, as the single biggest constraint to the garment sector's growth and competitiveness. According to GMAC, the share of energy costs in total costs (in the garment sector) rose dramatically in recent years, from 5 per cent in 2005 to 15 per cent in 2009. This is largely due to the cost of electricity, which at an average of \$0.18 per kWh is the most expensive in ASEAN (figure 2.4). However, it is not helped by the generally low level of awareness that enterprises show for energy management and efficiency.<sup>89</sup> Electricity is also highly unreliable, and factories have the stark choice of buying a generator or suspending their operations when the power is down. Together, these factors conspire to hold back efficiency throughout the private sector and thus undermine Cambodia's ability to compete with regional competitors like Thailand and Viet Nam.<sup>90</sup>

The next biggest constraint is productivity. A common complaint (and one that emerged in the enterprise study) is low worker productivity, with managers claiming that Cambodian workers produce less output for their efforts than those in other countries, in particular China and Viet Nam. Although the reasons given for this are often vague, available data seems to reinforce the claim. In the first half of the decade (2001–2005), Cambodia experienced the slowest rate of increase in labour productivity in manufacturing industries in the ASEAN region, according to data from the Asian Productivity Organization.<sup>91</sup> Additionally, although not the worst, Cambodia ranks low among regional competitors in terms of absolute value added per worker. At Cambodia's current level, labour productivity mirrors that of Viet Nam in 1993 – a level that is some three times lower than Thailand in 2005.<sup>92</sup> It does remain higher than Bangladesh, which has successfully competed with Cambodia due to lower wages, bulk production capacity and a more integrated domestic textiles industry.



<sup>89</sup> A 2009 survey conducted by ILO (BFC) and the International Finance Corporation found significant weaknesses in both energy efficiency and energy management in Cambodian factories. Among the key concerns in this regard included inefficient lighting, machines and air ventilation systems, and a general lack of energy audits (see ILO/IFC, 2009).

<sup>90</sup> The Government is aware of these challenges, and the issue is currently addressed in its national master plan, in which it aims to boost energy capacity by more than 3,000 megawatts by 2020. If this is achieved, the cost of power will be reduced, although to what extent remains uncertain.

<sup>91</sup> UNDP, 2009.

<sup>92</sup> *ibid*: 15,29.

The ability of workers to adjust quickly to changing buyer demands is also a major issue. A significant proportion of the surveyed employers noted that when asked to change product styles or patterns, their workers are comparably less able to adapt and respond than equivalent workers in Viet Nam. This is an interesting finding and one that warrants further investigation beyond this study. If verified empirically, it would imply that in Cambodia garment factories are comparably less equipped than their competitors to take advantage of niche opportunities in the market, which have typically higher returns than their conventional product lines.

While recognizing the productivity challenges, a small proportion of the surveyed employers expressed more positive views. These respondents, typically representing the more well-established (longer-standing) manufacturers, argued that following sustained improvements in recent years, productivity is no longer a primary concern to business competitiveness. This they attributed partly to the establishment of training institutions, such as the Cambodia Garment Training Centre, which aims to boost productivity and bridge skills shortages through the delivery of targeted courses.<sup>93</sup>



The third-biggest constraint to the success of the garment sector is high unofficial costs and fees. Two thirds of the surveyed employers said “facilitation fees” are typically needed to speed up everyday bureaucratic processes with government agencies. This finding is in line with previous research documenting Cambodia’s business environment. Some of the surveyed employers drew comparisons to regional neighbours, adding that although not unknown in these countries, informal fees cost more in Cambodia, thus undermining the competitiveness of both the industry and the economy vis-à-vis these producers.

Several other factors also ranked highly on the list of impediments to industry success, including a lack of skilled labour, the cost of inputs and transportation costs. Concerns about the cost of inputs stem largely from Cambodia’s position as an assembly base

<sup>93</sup> ILO/CAMFEBA, 2010.

for garment production, with little or no upstream supply functions in the domestic economy. In the absence of a domestic textiles industry, for example, factories have to import virtually all of the raw materials used in production – a process that weighs heavily on costs and competitiveness. This is not helped by the burdensome cost of electricity, which forms a large proportion of overall production costs, and the recent high levels of inflation. Some employers also expressed concern over the cost of labour, although when measured against regional competitors, Cambodia still looks to be in a good position (within Asia, only Bangladesh has lower wages).

### 3.4 Main survey findings and their implications

The enterprise survey offers important and instructive insights into how Cambodian garment factories were both affected by and responded to the economic crisis. At the outset, it was clear that owing to its particular structure – its export focus and the fact that those exports are mostly low-end products going to just two markets (the United States and European Union) – the sector as a whole was more vulnerable than any other in the country. While confirming the widespread nature of the downturn's impact, the survey provides indications of a differential impact across factories, both within the export sector and between exporting and non-exporting (non-GMAC) factories.

Main survey findings:

- Factories are typically large, with an average of 920 workers, albeit with much variation across the sector. Non-exporting factories are usually smaller in size and more likely to be both Cambodian managed and younger (having only operated in the country four to five years).
- Nearly nine in every ten factories was negatively affected by the economic crisis. Among the most commonly cited impacts were reduced export orders, increased pressure from buyers to reduce prices and increased cost of domestic inputs.
- Input cost increases and smaller domestic orders were more acutely felt by non-GMAC members. This probably stems from: i) their relatively weaker buying position and limited sourcing capacities outside Cambodia; and ii) their reliance on orders within the country, most likely from exporting factories struggling to cope with the impact of the economic downturn.

- Although most factories managed to increase and maintain revenues prior to the global economic crisis, revenues fell steeply in 2009. There was much variation, however: While some of the hardest-hit factories reported a decline in revenues of up to 75 per cent, some escaped with just a 5 per cent contraction. For most factories, expenses increased or stayed the same during the crisis, often leading to financial imbalances that put workers at risk of suspension and retrenchment.
- In response to the crisis, more than half of the participating factories made alterations to their workforce, most of which affected workers negatively. For non-exporting factories, this figure was even higher, at 100 per cent (ten factories). Measures taken include terminating temporary as well as permanent employees, reducing regular and overtime hours, negotiating cuts in bonuses and putting staff on “in-house (re)training” programmes to avoid outright lay-offs. Most of these measures likely harmed workers’ abilities to cover their own basic needs, not to mention remittances and the living costs of dependant family members. The survey findings show that factory floor (production) workers were the first victims of the downturn and were thus highly vulnerable to loss of hours and employment. Managers and non-production employees fared comparably better, with far fewer instances of income reductions and job losses.
- The study also revealed characteristics common to the factories that avoided the worst of the crisis. Reflecting again the differential impact between exporters and non-exporters in the industry, the survey evidence suggests that the best-performing factories were all GMAC members producing for export. Interestingly, these factories all also had the following: i) high levels of (perceived) productivity and few challenges finding skilled labour; ii) a harmonious industrial relations environment; iii) few problems with loss or theft of inventory; and iv) solid buyer-supplier relationships in the global supply chain.
- Overall, factory employers were optimistic about the future demand for their products. More than half said they expected demand to expand in 2010, relative to 2009. By and large, this has been confirmed by the improving aggregate picture in the sector during the same period, which shows a rise in garment exports in 2010 (see figure 1.1 in Chapter 1). Nevertheless, around one third of the surveyed employers remained unconvinced that the prospects would improve in the coming months. The majority of the employers said they expected to increase or maintain their current staffing levels, with less than 10 per cent anticipating further job



losses in 2009 and 2010. New recruitment does not necessarily mean employers plan to hire workers for a long period or on secure contracts.<sup>94</sup>

- Employers also highlighted a number of critical constraints to the industry's competitiveness going forward: i) the high cost of power; ii) low productivity; iii) high unofficial costs or facilitation fees; iv) the lack of skilled labour; and v) the high cost of inputs. Related perhaps to these factors, a worrying 70 per cent of the surveyed employers said they did not have any plans to expand their businesses.
- The study together with information from BFC synthesis reports show that despite considerable new pressures amid the economic crisis, earlier industry progress in improving working conditions remained largely unaffected. Aside from the minimum wage pressures and consequent industrial action by unions to raise the minimum wage in September 2010, the overall level of strike action in the industry fell. When there were strikes, factory employers generally did not associate them directly with the economic crisis.



<sup>94</sup> Indeed, worker-level research (discussed in detail in chapter 4) reveals a concerning trend towards the use of short-term and casual contracts, both of which entail less job security and fewer legal protections and entitlements than fixed and undetermined duration contracts. In this sense, new job creation in the post-crisis period appears not to be matching prior conditions in terms of employment quality.

## Box 3.1

### Recent developments in industrial relations

As Cambodia emerged from the crisis in 2010, its industrial relations environment became increasingly delicate. Much of the difficulties in this regard centred on proposed – and now implemented – adjustments to the minimum wage, which had remained unchanged since 2006. In June 2010, the Labour Advisory Committee agreed to a 9 per cent increase in the minimum wage, taking the base salary for regular workers to \$61 per month.

Although this has been accepted by some unions, it has sparked anger among others, some of whom have called for a “living wage” of as much as \$93 per month. This has set off a new round of protests and unrest that employers say is scaring off buyers and threatening the sector’s tentative economic recovery. In September 2010, nationwide strikes led to hundreds of dismissals, first of union leaders and then of members protesting against the dismissals. Although many were later reinstated following an appeal from the prime minister, a number of unresolved cases remain pending in the courts.

Employers argue that such a sharp increase to the wage rate (as demanded by some unions) is unrealistic in any circumstance, far less than the current post-crisis one. Some also claim that the importance of the issue is in itself overstated because most employers pay more than the minimum wage anyway. The ILO/CAMFEBA enterprise survey reveals an average monthly wage of \$84. With the new wage now in force, the options for further negotiation on the minimum wage appear limited. Instead, workers will likely turn to the issue of benefits, which employers say are still open for discussion.

A package of additional benefits concerning an increase in the meal allowance for overtime, seniority and attendance bonuses was agreed in March 2011, prompting some of the lingering industrial relations tensions and continued wage pressures to subside.

In other areas, important progress has been made. In a landmark agreement signed in September 2010, garment manufacturers and unions committed to wide-ranging improvements to labour relations:

- a commitment on both sides to abide by the law;
- a pledge by minority unions not to interfere with the rights and decisions of the majority ones;
- agreement that there will be no lockouts, strikes or other claims during the term of a collective bargaining agreement; and
- an agreement to use the Arbitration Council’s binding arbitration procedures on disputes over rights, violations of the law and existing collective bargaining agreement.

This new agreement, which comes in the form of a signed memorandum of understanding, provides an important basis for improving labour relations in Cambodia and reflects the growing maturity of the industrial relations environment towards the use of dialogue to resolve issues. Initially the agreement was to remain in effect for one year, but it was renewed in October 2011 for another year.

Sources: Phnom Penh Post (various); ILO, 2010



### 3.5 Concluding remarks

The enterprise survey and other primary and secondary data reveal a picture of the Cambodian garment factories – their strengths and weaknesses. It is clear from this picture that garment factories are only weakly embedded into the domestic economy, as Heintz<sup>95</sup> also notes. This is not just due to their predominantly foreign ownership and export focus but also to the lack of domestic supply chain links, most notable of which is an upstream textiles industry. Unlike some of the foreign competitors, Cambodian garment factories must import nearly all the fabrics used in production, a factor that adds both to production costs and lead times. Consequently, with little reliance on the domestic economy (for investment, sales or raw materials, for example), the garment sector has assumed an enclave-like character in the domestic economy. However, its impact on employment means that its spin-off effects are important, whether positive or negative. With new low-cost production frontiers emerging from time to time and certain existing ones developing new competitive edges, Cambodia remains one of a number of countries in which the reluctance of garment factories to make substantial long-term commitments is an ever-present concern for policy-makers.

Although largely vulnerable to the economic crisis, there are factories that were little or less affected by it. There are important lessons to be learned from them. For instance, some analysts contend that higher productivity enabled some factories to better withstand the intensified pressures they encountered, in particular reduced demand, heightened competition, tightened access to credit and disrupted supply chains.

The survey findings on labour standards from the enterprise perspective deserve further analysis. The findings reflect potentially serious implications for the achievement of decent work and improved working conditions in the garment sector. As per the current labour laws, beyond severance pay and lay-off compensation, garment factories are not legally obliged to provide any other type of assistance to laid-off staff. The survey revealed just a fraction (5 per cent) of exporting enterprises had provided any kind of assistance to their employees after retrenchment. Of those that did, it was typically in the form of informal help with job searching and various kinds of post-employment advice and counselling. The extent to which this support was helpful for those workers, however, was not canvassed.

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<sup>95</sup> Heintz, 2007.

The issue of skilled labour is a contentious one. Previous research conducted by UNDP, for example, concludes that a lack of skilled labour is not a major inhibiting factor in the sector's growth, at least in what concerns basic production functions. Within the sector there is a general recognition of the need to improve the skills of the garment workforce as a means to enhance labour productivity and diversify the sector into higher-value, more skills-intensive types of apparel (including footwear). This too applies to non-production positions, which are all too often filled by foreigners (in apparent response to the lack of equally qualified locals). The Cambodia Skills Development Center (CASDEC, formerly known as GIPC, the Garment Industry Productivity Center) was established precisely to build up local skills and capacity among Cambodian workers, not only to expand their own career prospects but to enable them to contribute more readily to the competitiveness of the garment sector at both the production level and in management.

Factory employers usually agree that for the garment sector to diversify and upgrade its business model (to more lucrative products), greater investments will be needed in the Cambodian workforce, particularly training Cambodian managers of the future. Such developments would not only reduce indirect labour costs (expatriate salaries are often several times the level of a suitably qualified national) but would also help root the industry more strongly in the domestic economy and provide new incentives for diversification and new autonomy for factories wishing to pursue niche-market production.

For factories to attract young Cambodians to non-production jobs, the industry needs to make these positions better known and more attractive. The garment sector continues to suffer from an image crisis, which tends to deter skilled young people from considering it as a viable career option (most are unaware of the opportunities in the sector, instead associating garment work with low wages and poor working conditions). Despite this, the situation is improving thanks to various recent initiatives to improve both basic and technical skills directly applicable to the garment sector. GMAC, for instance, will soon launch a National Garment Training Institute (it is experiencing delays due to funding constraints) while a number of sector-specific degree courses are now available at Norton University, Institut de Technologie du Cambodge, University of Cambodia and the National University of Management (all facilitated by CASDEC). A certificate in production management for the garment sector is also available at the University of Puthisastra as part of a collaborative scheme with CASDEC.

### **Box 3.2**

#### **Is Cambodia still a good place to do business?**

**Despite recent improvements, businesses in Cambodia still face a number of obstacles that undermine their growth and competitiveness.** Cambodia's overall ranking in the World Bank's *Doing Business Report* fell two places in 2011, to 147th of 183 economies. Economists attribute this to continued, and in some cases worsening, challenges in obtaining credit, protecting investors and enforcing contracts. Although the first factor may have been expected given the recent economic downturn, the other two are indicative of a weak regulatory environment, which adds to investment and business risk.

**Opening and closing a business can be time consuming and bureaucratically demanding.** It often requires the payment of bribes and informal fees. This too reflects poorly in the country's *Doing Business* ranking: 170th (of 183 countries) for opening a business and 183rd for closing a business. With regard to starting a business, although the cost of the process has typically fallen in recent years, little progress has been made to streamline or reduce the number of procedures required.

**Cambodia also fares badly (ranking 118th of 183 countries) in terms of trading across borders – a critical process for garment and other export industries.** In 2010, exports took 22 days to move across borders while imports took 26 days, with document preparation taking up more than half of this time. Although an improvement on previous years (in 2008, exports took 37 days and imports took 45 days), this remains longer than for most of Cambodia's apparel competitors.

**Corruption is arguably the biggest contributor to business and investment risk and uncertainty in Cambodia.** Garment factory owners in particular consistently cite corruption as a major constraint to growth, with studies showing this to cost as much as 6 per cent of total annual sales (Heintz, 2007).

**A poor business environment creates uncertainty for foreign investors, which encourages shallow or “footloose” investment, often financed offshore.** As a result, countries are less likely to receive the positive externalities of foreign investment because links and interactions with the domestic economy are weak. Domestically, while a poor business environment is profitable for rent-seekers, it is harmful to small and medium-sized businesses (SMEs). In a country such as Cambodia, where SMEs form the bulk of enterprise activity, this represents a major constraint to economic dynamism, income generation and livelihood improvement.

Source: World Bank, 2011





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## Worker-level impact: Garment workers and the economic crisis

# 4

## 4.1 Introduction

Cambodian garment workers were particularly vulnerable to the economic crisis due to their position at the bottom of the global garment supply chain. Their situation was made more precarious by the sector's reliance on just a few foreign export markets, as well as its narrow product mix and concentration in mass-market, low value-added goods. Accordingly, as consumers in the US and EU markets cut back spending amid worsening recessions, Cambodian producers felt the pinch. Order volumes and prices for garments began to fall, forcing many factories to cut overtime, suspend production and, in some cases, close down. By late 2009, the fallout was already evident, with more than 70,000 jobs lost and 70 factories closed. For those that remained in business, sweeping workplace austerity measures ensured that financial hardships were felt not just by the retrenched but also by those lucky enough to have kept their jobs.

Owing to the composition of the industry's workforce, the crisis had a disproportionately severe impact on mostly poor working women. As previously noted, the bulk of factory workers are young women from the provinces, most with little education or formal skills. For many, factory work had given them an opportunity to break out of rural poverty and provide regular financial support to their families. After more than a decade of impressive economic growth, the downturn offered a stark reminder of the structural weaknesses of the sector in which they work and the acute vulnerability this generates for them and their families.

Although much was written about the plight of garment workers during the crisis, most of this was based on circumstantial rather than empirical evidence. In recognition of this as well as its long-standing association with the industry, the ILO initiated an in-depth study of garment workers in early 2009 to examine the impact of the crisis on them and to generate evidence with which to base future policies and programmes that support the factory workforce. Central to this was the need to uncover changes to worker conditions over time, something that could only be achieved by monitoring a group at several different stages during the downturn. Accordingly, a study was devised with the Cambodia Institute for Development Study (CIDS) to track 2,000 workers over a six-month period.





## 4.2 The worker tracking study

### *Methodology*

The worker tracking study was launched in September 2009 with 2,000 individuals randomly selected from a database of currently employed and recently retrenched garment workers in and around Phnom Penh. Of them, 1,200 were selected in the currently employed category; the remaining 800 were those who had lost their factory jobs in the period since January 2009, having either been terminated due to factory lay-off or closure or resigned for reasons specifically linked to the crisis (such as income loss and work suspension). At the time of the study launch, they were still unemployed. Reflecting the broader structure of the industry, only a small proportion of workers in each category were male (96 of the 1,200 employed and 64 of the 800 unemployed).

Due to the disparate nature of the two groups, a uniform sampling methodology could not be applied to both. As would be expected, the sampling unit for the “employed” group was the number of factories in operation, the numbers of which were obtained from the MOLVT. With 332 factories registered (both exporting and non-exporting), a sample size of 178 was calculated as sufficient to give a confidence level of 95 per cent and a representative picture of the sector-wide situation of these workers. During the initial benchmarking survey, some 21 more factories were added to the sample, bringing the total to 199.

**Table 4.1: Sampling methodology for the two worker categories**

	Employed	Unemployed
Targeted population	Workers currently employed in factories that are in operation and/or temporarily closed (suspended) <sup>96</sup>	Workers who have been retrenched from the garment sector since 1 January 2009 and who remain unemployed at the time of surveying
Sampling unit	Factories in operation	District in which workers live/work
Sampling method	Simple random sampling: <ul style="list-style-type: none"> <li>• Targeted sample size: 178 operating factories; confidence level 95%, confidence interval of 5%</li> <li>• Factories randomly selected from list of factories in operation using SPSS statistical software</li> <li>• Workers at targeted factories randomly selected for interview</li> </ul>	Cluster sampling: <ul style="list-style-type: none"> <li>• Sample size: weighted by four district groups, based on number of closed factories in district:               <ul style="list-style-type: none"> <li>- Dangkor (30% of interviews)</li> <li>- Meanchey (30% of interviews)</li> <li>- Reussey Keo (30% of interviews)</li> <li>- Other (10% of interviews)</li> </ul> </li> <li>• Workers at targeted districts randomly selected for interview</li> </ul>

<sup>96</sup> By law, factories undergoing temporary suspensions are allowed to cease trading for a maximum of two months, after obtaining official permission from the MOLVT.

Determining the sample unit for unemployed workers was more complex. Unlike the employed, of whom factories provided the basis for sampling, it was not possible to use existing closed factories in the same way because it would omit both those who were retrenched due to enterprise downsizing and those who resigned because of other reasons still related to the crisis. The research team thus employed a geographical cluster focus for sampling, weighted by the percentage of closed factories in key districts. This was possible due to the knowledge that workers usually live in the same district as their place of work, as well as government data showing that 90 per cent of recent factory closures had taken place in just three districts of Phnom Penh. On this basis, a target was set for 30 per cent of the sample to come from each of these districts (amounting to 240 workers per district), with the remaining 10 per cent randomly selected from various others. Unfortunately, difficulties in obtaining interviews in certain areas skewed the sampling somewhat, resulting in the dominance of one district in particular (with 47 per cent of the 800 respondents). Nevertheless, the weighting was not deemed detrimental to the overall authority and representativeness of the study.



The research consisted of an initial benchmarking survey with the original 2,000 workers, followed by two subsequent “tracking” surveys at three-month intervals. Surveying was conducted in stages, with benchmarking taking place in September–December 2009, and subsequent tracking exercises in January–March and April–June 2010. From the original 2,000 workers surveyed, the research team managed to locate and re-interview 1,008 workers at the first tracking stage and 712<sup>97</sup> (of the 1,008) at the second. Although not ideal, this sample loss was unavoidable but did not unduly influence the quality of the overall findings.

To analyse trends in worker hardships and coping strategies, sample respondents were categorized

97 The sum of workers exceeds 712 workers surveyed in the second tracking because 41 workers in the “recently unemployed” group had already found a job and were thus also counted in the “recently found” new job group.



into six groups. First were the long-term employed, namely those who had remained employed at the same factory throughout the study, from benchmarking to the second tracking stage. Second were the long-term unemployed, which referred to workers unemployed throughout this same period. The third group were those employed as of the first tracking stage, which encompassed workers who had found a new job at that time and then kept it through the second tracking stage. Fourth were the unemployed the from first tracking, which refers to previously employed workers who had been terminated by the time of the first tracking and who remained unemployed thereafter (until the end of the study). The fifth group was the recently unemployed, comprising workers who had been employed at the first tracking stage but were jobless at the time of the second. The sixth group was the so-called “recently employed”, those who were unemployed at the first tracking stage but had by the second tracking found a new job. A summary of the numbers in each of these categories is outlined in figure 4.1.

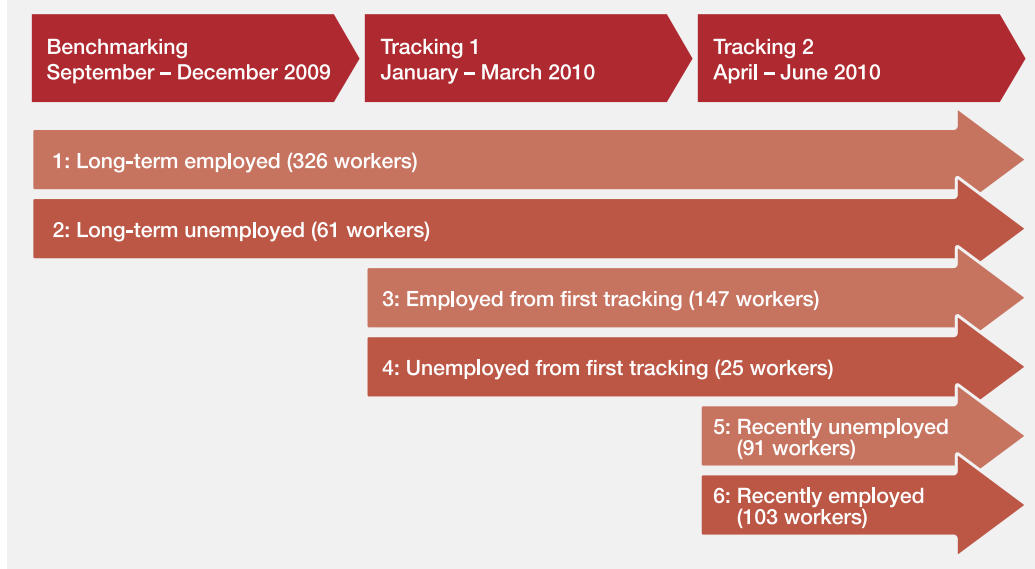
#### **Box 4.1** **Survey questions**

Interviewed workers were asked a range of questions for the study, covering the following main themes:

- Basic information
  - name, age, home province
  - education, skills and experience
  - employment status
- Impact of the crisis
  - changes in pay and factory conditions
  - hardships experienced
  - impact on basic expenditures (food, housing, health care, remittances)
  - impact on employment status
- Responses and coping strategies
  - cutting back spending
  - return migration
  - added family workers
  - new employment
  - job search strategies
- Legal issues
  - factory adherence to labour

One of the major difficulties for the research team throughout the study was maintaining contact with workers after the initial baseline survey. Due to a range of factors beyond the control of the team (which included workers changing their phone numbers, selling phones and moving to new locations without informing colleagues or landlords), it was only ultimately possible to track less than half of the original 2,000 workers to the end of the study. Although the final result was disappointing, the large size of the original sample helped ensure that the residual numbers remained considerably higher than those of earlier studies and thus preserve the overall representativeness and authority of the findings.

Figure 4.1: Worker categories, by tracking period



## 4.3 Findings by worker category

### *Long-term employed*

The long-term employed workers were those who remained employed at the same garment factory throughout the study. The evidence shows the average salary of these workers rose slightly over time, from US\$82 per month at benchmarking to US\$91 per month at the second tracking stage – much of which can be attributed to the rebound in overtime that came towards the latter stages of the crisis. By the time the study had begun, the economic crisis was already well rooted in Cambodia; as far back as early 2008, when the country experienced rampant inflation, garment workers had endured a range of financial hardships that had weakened their (already low) capacity to deal with external shocks. As a result, outstanding debts and the depletion of assets prior to 2009 may have in some cases offset the more recent income gains of workers.

Other hardships also seemed to ease during the course of the study. The first and second tracking surveys coincided with what was deemed to be a stabilizing period of the economic situation, which may explain the apparent decline in workers' difficulties (by proportional share of workers affected), such as overtime reduction, compulsory leave and work suspension. Of them, loss of overtime was by far the most common at the outset – some 52 per cent of employed workers cited this as a problem during the

benchmarking survey. By the third survey, in April–June 2010, this figure had dropped to just 22 per cent. Similarly, the proportion of workers experiencing paid compulsory leave fell from 30 per cent to 10 per cent in the same period, and work suspensions went from 13.5 per cent to less than 1 per cent (table 4.2). One caveat to these findings is that they are based on steadily diminishing absolute numbers – a product of the sample loss over time. Despite this, it remains clear that there was a solid downward trend in the prevalence of hardships between late 2009 and mid-2010.

**Table 4.2: Hardships experienced by long-term employed workers**

Trend of hardships	Benchmarking		Tracking 1		Tracking 2	
	Frequency	%	Frequency	%	Frequency	%
Decreased in safety and health	132	40.5	107	32.8	152	46.6
More difficult to ask for days off	153	46.9	123	37.7	103	31.6
Reduced or no overtime	170	52.1	80	24.5	71	21.8
Paid compulsory leave	98	30.1	45	13.8	33	10.1
Restrictions on unionization	27	8.3	22	6.7	15	4.6
Late payment of salary	34	10.4	23	7.1	6	1.8
Reduced working hours	11	3.4	5	1.5	3	0.9
Shorter work week	13	4.0	5	1.5	3	0.9
Unpaid compulsory leave	11	3.4	6	1.8	3	0.9
Work suspensions	44	13.5	27	8.3	2	0.6
Reduction or elimination of bonuses	20	6.1	7	2.1	2	0.6
Change in type of contract	0	0.0	1	0.3	1	0.3
Deductions in salary	3	0.9	0	0.0	0	-
Duration of contract shortened	0	0.0	1	0.3	0	-

Source: ILO/CIDS, 2010

Amid this general trend, some issues remained a significant problem for employed workers. Many, for example, still complained of worsening health and safety conditions in the factory and difficulties in asking for time off, even at the end of the study (47 per cent and 32 per cent of the workers, respectively). Several explanations for this could be possible. Taken at face value, the trends may suggest that managers actually changed their practices regarding health, safety and leave criteria. It may also be true that, in some cases, workers' testimonies were skewed by perceptions rather than fact, something that is more possible for issues like health and safety than income and working hours (where the results are tangible numbers). For example, while some workers pinpointed clear and measurable deteriorations in health care and safety provisions in their workplace (including fewer doses of medicine from the factory clinic and poor ventilation due to disconnection of air conditioners), others may have mistakenly conflated "worsening health and safety conditions" with

their own general well-being, which could have declined for a number of reasons. Similarly, increased difficulty in asking for days off might have been a product of being more fearful to ask, in view of the heightened risk of retrenchment.

In terms of the responses and coping mechanisms of the long-term employed, exactly half of them had borrowed money from a money lender by the end of the study, with more than a third saying they had borrowed from friends and family (some workers may be included in both groups). As might be expected, this coincided with the depletion of savings for those who were lucky enough to have any – just 4.9 per cent of workers reported using savings as a coping strategy at the end of the study, compared with 16 per cent in the first tracking stage. These results also reveal the strong preference workers have for informal and family-based borrowing as opposed to more formal arrangements, such as bank loans. This reflects the widespread under-utilization of the banking system by garment workers, perhaps out of mistrust but also probably due to a lack of understanding of the financial sector and the comparably more widespread presence of informal money lenders.

In addition, many workers cut back on important expenditure items, such as food, health care and transportation, all of which are likely to have had negative impacts on their own health and living standards. Importantly, the study also revealed that more than half had reduced the level of remittances they sent home to family members in the provinces. As noted earlier, this had implications for a number of socio-economic and development indicators in those communities, some of which were captured in the study findings. For example, over the course of the study, some 12 per cent of workers' families (in the long-term employed category) made the decision to send another household member into the labour force, ostensibly to find work to offset the loss of remittances from their relative working in a garment factory.

### *Long-term unemployed workers*

Long-term unemployed refers to the workers who remained unemployed throughout the study. At 61, this number is surprisingly low; however, informed assertions made by the research team would suggest that a large proportion of the workers who disappeared from the sample between the benchmarking and second tracking stage also belonged to this group. While obviously not verifiable (if it was, these workers would not have been lost), such assertions were drawn from discussions with informants close to the missing workers, including trade union

officials and former landlords and colleagues. On this basis, an average of 70 per cent of the lost workers at the first and second tracking surveys were likely to have been unemployed.

Throughout the study, many of the long-term unemployed migrated back and forth between Phnom Penh and their home province in search of work. Few had any luck, and their financial burdens typically grew in tandem with the length of their unemployment. A greater proportion of the surveyed workers financed the early part of their unemployment with personal savings. Once these funds were depleted, increasing numbers took to borrowing, most commonly from friends and family but also from private money lenders. Perhaps reflecting the inherent difficulties that workers face in finding alternative jobs outside the garment sector, only a handful managed to secure even a temporary job, such as selling perfume or food or washing clothes. This may also

suggest that few workers were actually interested in this type of work (the general employment preferences of these workers indicates this). When asked, more than 80 per cent in this group said they were specifically looking for factory work, while the remainder were seeking jobs in the services sector (including restaurants, food vending, tailoring and so on).

As with workers in other circumstances, the families of many of the long-term unemployed also sent another household member, typically a young female sibling, into the labour force to search for work to offset the income loss of the main earner (the factory worker). In these circumstances, in which the primary income earner

#### **Box 4.2 Case study Long-term unemployment**

Originally from Svay Rieng Province, Houn Nak worked in the garment sector for five years until her retrenchment in August 2009. She was unemployed at the time of the benchmarking survey and remained unemployed six months afterwards (at the end of the study).

Now 31, Ms Nak lives in Phnom Penh with her husband, who also works in a garment factory. During her long period of unemployment, they survived on her husband's income, which, inclusive of allowances and overtime, was around \$120–\$130 per month.

Recently Ms Nak started a laundry service for people in her community. She washes around 30–40 sets of clothes per week, earning roughly 7,000 riels (\$1.75) per day. Since her retrenchment, she has bought rice on credit every few months, around 50 kg each time, worth around \$33. With their limited income already stretched thin, she says it is hard for her and her family to repay the rice dealer, meaning they are constantly in debt.

suffers not just income reduction but complete job loss, it is likely that the imperative for such a household response would have been more intense.<sup>98</sup> Confirming this, the research shows a sharp spike in the number of workers whose families adopted this strategy between the benchmarking and final tracking stage – from 4 per cent to 31 per cent. This contrasts with the equivalent share among the long-term employed, which remained at around 12 per cent throughout. Interestingly, the bulk of this increase took place in the second half of the study, which suggests that sending the added worker to find employment was not an immediate family response but one that came after the exhaustion of other strategies and/or the depletion of family savings. As in all cases of this kind, the “second” income earner typically sought work in the garment sector – a trend that is likely to reflect both the absence of broader labour market knowledge and the general perception that garment factory work is easier to obtain than other jobs (due to existing networks and contacts and low skills requirements, for example).

### *Previously retrenched but now re-employed*

One eighth of all the surveyed workers were retrenched sometime after the benchmarking exercise but subsequently found new employment.<sup>99</sup> Among them, many endured the same type of hardships as other groups during the downturn, including difficulties in meeting basic needs and expenditures, particularly during the job search period, as well as the need to cut back spending on essentials like food, housing and remittances to the family. They too resorted to borrowing money once their savings were depleted and sought out a loan from family and friends rather than a bank. However, on a range of other issues these re-employed workers provide interesting new insights, most notable of which relate to the conditions of their re-employment and ensuing workplace experiences.

Despite the mass retrenchments during the height of the crisis, evidence from the surveyed retrenched workers suggests that the industry still retained a significant capacity to re-absorb labour. This is evident in the finding that among the 103 workers who found new jobs between the first and second tracking surveys, more than three quarters had returned to the garment sector. This also lends weight to the suggestion that for all the oft-cited hardships of life in the factories, many workers still prefer this type of employment to the alternatives on offer.

<sup>98</sup> Of course, this also depends on the extent of the household's reliance on the factory worker's remittances, which will vary from family to family.

<sup>99</sup> These workers then retained this employment for the remainder of the study.

Because of their status, re-employed workers might be considered fortunate, at least when compared with other retrenched workers without employment. However, the study reveals the new job often came at considerable potential cost to workers' employment quality and security. While for the most part it seems relatively few had lost out in terms of earnings (only 16 per cent cited a decline in income in their new job<sup>100</sup>), there are worrying trends in the growing use of short-term and more insecure employment contracts.

Between the first and second tracking exercises, for example, the proportion of new recruits receiving a three-month contract rose from 27 per cent to 37 per cent. In the same period, the proportion receiving a casual or probationary contract also increased, from 39 per cent to 46 per cent, and 18 per cent to 25 per cent, respectively.<sup>101</sup> For these workers, this represented a significant deterioration in the quality of their employment: Aside from reducing job security, these contracts make them easier to terminate and offer them fewer legal protections and entitlements if they were.

### *Retrenched during the course of the study*

Nearly 12 per cent of the workers in the sample were retrenched at some point between the first and second stages of tracking and remained unemployed.<sup>102</sup> From this group, a consistent rate of retrenchment of 12.8 per cent (of the total sample size) was calculated for the duration of the study, virtually all of which related to the garment sector.<sup>103</sup> Although this rate remained stable, the actual reasons for termination appear to have changed over time. At the benchmarking stage, some 89 per cent of (terminated) workers had been fired due to factory closure or downsizing; by the end of the study, this figure had fallen to just 19 per cent. In its place, an increasing proportion of workers – 9 per cent at the benchmarking period, rising to 53 per cent by the second tracking survey – had resigned of their own accord, primarily in response to low income and resulting hardships.<sup>104</sup> The emerging implication here is that although job cuts from the factories appeared to have stabilized (something that would be expected, given the stabilizing of the economy towards the latter stages of

100 CIDS, 2010: 31.

101 Although these figures are based on aggregated data across various occupations, the fact that the vast majority of the workers in this group were employed in garment factories means it is this sector that accounts for the bulk of these trends.

102 In the study report, the researchers divided these workers into two groups: those retrenched at the first tracking stage and those retrenched at the second. In the interests of discussion, the two groups have been combined in this book under the single heading of "retrenched during the course of the study".

103 Just two workers in the entire study were retrenched from other sectors. Omitting these workers, the retrenchment rate for the garment sector alone was thus 12.6 per cent.

104 This should not be confused with falling incomes, which from the evidence appears to have diminished in prevalence during the course of the study. This finding is more likely to reflect general dissatisfaction with wages in the industry or the worker's own factory than an observable decline in their earnings.



the study), there remained considerable unease within the remaining workforce – so much so it seems that some were still prepared to brave an uncertain labour market in search of new and ostensibly better job opportunities.<sup>105</sup>

However, a comparison of these findings with those of the re-employed reveals an apparent paradox. On one hand, it is evident that an increasing share of “terminations” in the sector were actually voluntary resignations. But the testimonies of the re-employed workers show that the garment sector was still the preferred choice for most, since most of those who found new work did so in the garment sector. This suggests that contrary to the earlier impression that workers were increasingly seeking a way out of the factory, a more plausible assumption is probably that they were seeking a better deal in a different garment factory. Although labour turnover in the industry is typically quite high (table 4.3), this does not mean that when workers leave their job they leave the sector.<sup>106</sup> Indeed, given the widespread lack of alternative job opportunities for workers of this profile today, it is perhaps little surprise that many end up back in a garment factory, despite what they may have otherwise aspired to.

**Table 4.3: Workforce turnover in selected garment factories**

Percentage of workforce turnover	Number of factories	Percentage of factories
0–5	24	40%
5–10	12	20%
10–20	16	27%
20 or more	8	13%
Total	60	100%

Source: USAID, 2005

High labour turnover is partly the result of low wages and the often generic nature of production jobs across the garment sector. Given this flexibility, together with the generally modest wages on offer in most factories, it is perhaps understandable that the prospect of earning even a few extra dollars per month (or the opportunity to earn such through extra overtime, for example) can often be enough for a worker to switch jobs to a new factory. In doing so, workers boost the labour-turnover figure and thus the reputation of the industry as a somewhat unstable environment in which to do business.

<sup>105</sup> This too may reflect a general misunderstanding of the economic crisis in Cambodia among garment workers, which may have led them to the conclusion that the crisis was confined to the garment sector and that jobs were still widely available outside the garment factories.

<sup>106</sup> For further research and discussion on labour productivity in Cambodian factories, see USAID, 2005 and Ear, 2009.



Echoing research conducted prior to the crisis, evidence from this study suggests that the longer that unemployment prevails for retrenched workers, the more likely they are to stop looking for work altogether and return home to the province. This is in line with the general finding that as unemployment continues, it becomes increasingly untenable for most workers to remain in the city, where living costs are high and family support networks are usually weak. Hence, despite the widespread dearth of productive employment opportunities in these areas (employment scarcity is arguably the most significant factor driving workers from the provinces to the garment sector), many in this position opt to return to avail of short-term family support and in some cases help out with small household and agricultural tasks. In many instances, workers continue to keep an eye on job opportunities in the city and particularly in the garment sector, relying on friends to provide information on vacancies.

Laid-off workers also reveal important insights to the procedures followed by employers when retrenching staff and, in particular, how well they complied with the labour law (table 4.4). Two key components are notable in this regard. One is the financial compensation workers are entitled to upon termination of their contract, which typically consists of either lay-off compensation or severance pay, depending on the type of contract. The second is the notice of termination, the requirements for which vary by contract type and length of employment. On both counts, the study found compliance by employers to be poor. This was clear from the outset of the study, when two thirds of retrenched workers entitled to lay-off compensation had not received it. However, by the end of the study, it was worse: no entitled workers had received their benefits.

By contrast, the situation vis-à-vis termination notice was somewhat better and improved over time. At the benchmarking stage, a fifth of workers entitled to advance notice received it. Although this did not improve much during the first half of the study (at the first tracking stage this figure was only slightly higher, at 24 per cent), by the final tracking stage nearly 60 per cent of entitled workers had received notice of termination from their employer. Despite this, the evidence still points to an alarming level of non-compliance among garment factory employers during the economic crisis. To the extent that not complying with the law appears to have been the norm rather than the exception during this time, the findings suggest significant failings either in the law itself or in its application and enforcement at the factory level.

These conclusions require some words of qualification. First, the researchers did

not investigate any further into either the validity of the workers' responses nor the rationale for their answers. It is also important to highlight the inherent bias in a study in which one party – in this case, the employers – is not invited for comment. Evidence from the enterprise study suggests a somewhat different picture from that obtained in the worker tracking study.

**Table 4.4: What does Cambodia's labour law say?**

On compensation	On notice of termination
<p>Compensation entitlements depend on the worker's contract and, if the contract length is undetermined, the length of employment.</p> <p>1. Fixed-duration contracts (FDCs) Entitlement: severance pay of at least 5% of total wages paid during the length of the contract</p> <p>2. Undetermined-duration contracts (UDCs) Entitlement: lay-off compensation, based on length of employment: - 6 months to 1 year employment: 7 days' wages + benefits - more than 1 year employment: 15 days' wages for each year of employment and up to 6 months' wages and benefits (fractions of half a year or more are counted as a full year)</p>	<p>Termination notice depends on both the type of contract and duration of employment. Employers who fail to give notice must pay the employee the wages and benefits that he/she would have earned during the notice period.</p> <p>1. Fixed-duration contracts If the employer wants the employee to stop working at the end of his/her FDC, the notice required is as follows: - 6 months or less employment: no notice required - more than 6 months employment: 10 days - more than 1 year employment: 15 days</p> <p>2. Undetermined-duration contracts The employer must give written notice to the employee with the following notice periods: - less than 6 months employment: 7 days - 6 months to 2 years employment: 15 days - more than 2 years and up to 5 years: 1 month - more than 5 years and up to 10 years employment: 2 months - more than 10 years employment: 3 months</p>

Source: ILO, 2005

### *Job-seeking strategies*

The findings from unemployed respondents offer unique insights into the ways garment workers tried to find work after retrenchment. Throughout the study, most unemployed workers relied upon the same few sources of information for job opportunities, namely themselves and their family and friends. The findings show that many (re-employed) workers found a job on their own by driving around town checking for advertisements and asking factory guards and other staff for information. In addition – and if that approach failed – workers turned to people they knew, particularly those in a factory, for inside information on job vacancies. Beyond this, few if any workers used other sources, and this includes even relatively basic and accessible mediums such as newspapers and radio.<sup>107</sup>

<sup>107</sup> Even less well used were recruitment agencies, trade unions and previous employers, although in the latter case, there appeared in the first-tracking findings to have been a spike in workers asking their former employer for assistance.

The study also underscores the widespread absence of public employment services in Cambodia today as well as the low level of awareness of those services that are available. Despite the launch of two new job centres in 2009, including one in Phnom Penh, government-run services of this kind remain weak, both in terms of quality and quantity (including accessibility). For garment workers, together with many others who lack the means and knowledge to access the full scope of labour market opportunities, this represents a significant barrier to job searching and career prospects.

#### **Box 4.3 Case study** **Cyclical migration and job searching**

Chea Na Lin worked in the garment sector for three years before her factory closed in August 2009. During the ILO benchmarking survey, she was in Phnom Penh looking for a garment factory job. She tried to find a job by riding around town to see if there were any vacancy announcements in front of factories. She also asked security guards at different factories if there were any job openings at their factory.

Unsuccessful and with funds running out, Ms Lin, now 22, returned to Takeo Province to help her family on the farm. In June 2010, she returned to Phnom Penh again to look for a garment factory job. She was initially successful, but after one month she was laid off again because the factory had no work. She is now back to looking for another job but says that if she cannot find one within a few days she will return to her family in the province.

Owing in part to the limited social safety nets in Cambodia as well as their low wages while employed, unemployed workers suffered acute difficulties in covering their basic living costs during the job-seeking period. The majority had little if any savings and, as already noted, relatively few received the correct compensation payment from their employers. Consequently, job searches were typically constrained by a lack of finances to cover even a short period of unemployment, a period that itself is likely to have risen due to the growing chasm between labour supply (of new job seekers) and labour demand. In some cases, this meant that workers took a job with a lower income and less favourable working conditions than they would have otherwise accepted.

Despite the seemingly well-known troubles in the garment sector, the majority of retrenched workers in the study still preferred to look for a job in a factory – even at the expense of possibly higher-paid alternatives. In the benchmarking survey, more than 60 per cent of the job seekers were looking for a factory job – a figure that increased to 74 per cent in the first tracking stage and 83 per cent in the final stage. Such increases may reflect the easing of the crisis in 2010 and the subsequent relaxation by employers of earlier recruitment freezes.

## Box 4.4 Increasing vulnerability in employment

Throughout the economic crisis there was much speculation about the potential trend of retrenched garment workers moving into various jobs in the “entertainment sector”, in particular, commercial sex work, as a means to cope with unemployment and the new hardships. Owing to recent changes in the regulatory environment that made brothel-based sex work illegal, this type of work has assumed an increasing presence in entertainment venues such as karaoke halls and beer gardens, where it is now often concealed but widely solicited. It is in these more dispersed settings that increasing attention has been placed on the presence of ex-factory workers, many of whom appear to have moved into this type of work out of desperation, both with the lack of other opportunities available and the sense of obligation for supporting their families financially.

An ILO study conducted in 2009 provides important insights into the experiences of ex-garment employees now working as so-called “indirect” sex workers in the entertainment sector. The study targeted a small group of women recently retrenched or resigned from the factories to better understand the vulnerabilities these women experienced in the context of HIV prevention. According to the survey findings, the decision to start selling sex was borne out of financial necessity after they started working in the entertainment venue because their basic salary was insufficient to cover their food, housing and remittance expenses.<sup>1</sup>

All the surveyed women experienced some form of abuse from customers, although most of it took place in their regular workplace rather than during the course of a sexual transaction. Few were versed in dealing with unwanted advances from clients and thus most were ill-equipped to protect themselves. When staying with a client, most workers relied only on guesthouse security guards for protection.

Although condom use and awareness of sexually transmitted disease was high, many of the women did not practise safe sex with trusted “regulars” and/or non-commercial partners (boyfriends and husbands). The study conclusions pointed out that amid the economic downturn, sex workers held reduced bargaining power over condom use – something that may in some cases have led to women being coaxed into unsafe sex. Added to the fact that entertainment venues are no longer covered by the previously successful 100% Condom Use Programme,<sup>2</sup> it appears significant challenges remain in protecting the health of sex workers in their new workplace context.

When asked to compare life now with their time in the garment factory, almost all said they preferred their current job because it better enabled them to support themselves and their families financially. Most also remarked that life was harder in the factory and that entertainment and sex work gave them greater flexibility and independence. That said, most remained unsure as to whether they would stay in the entertainment sector, long term, with a few considering a return to the factories.

The study’s recommendations included launching a campaign to prevent worker abuse in entertainment establishments; the distribution of educational materials to address workers’ vulnerabilities to abuse and HIV infection; and strengthening mechanisms to inform them about their basic rights at work, such as fair wages and union membership. A licensing process for entertainment establishments that includes a basic set of conditions for employers was also recommended, along with a tripartite monitoring mechanism to examine working conditions in entertainment establishments.

<sup>1</sup> The study was conducted by the Australian development agency Union Aid Abroad (APHEDA), which has extensive experience working in Cambodia and with direct and indirect sex workers in the country.

<sup>2</sup> With the 100% Condom Use Programme, sex workers must refuse unprotected sex with clients on the instruction of the owner and manager of their workplace. Knowing they have the support of their employers, women who provide sex services can insist on condom use and refuse a customer if he does not agree (WHO, 2000).

## 4.4 Concluding remarks

The evidence uncovered in the tracking study reveals wide-ranging impacts at the worker level as a result of the economic crisis in the garment sector. These impacts were not only multiple but also widespread across the industry, affecting both the newly retrenched and those who remained in employment. For the most part, these hardships can be linked, either directly or indirectly, to a reduction in income, itself most commonly due to reduced overtime hours.

General findings and conclusions are as follows:

- The data reveals an overall net decline of around 20 per cent in garment sector employment, from 1,200 employed workers at the benchmarking stage to 958 at the second tracking stage.<sup>108</sup> Unemployment rose during the same period, from 800 to 987. At the same time, the sector displayed considerable absorption capacity for labour – a finding most evident in the large number of workers re-employed in a garment factory.
- Although a significant minority (16 per cent) of the workers remained employed in the same factory throughout the study, a larger proportion appeared to change their status one or more times. This in itself does not mean that all changes were negative; indeed, some workers simply moved from one job to another with no loss –and in some cases even a gain– in income and welfare. Given the fact that net unemployment within the sample actually increased during the study period, it is likely that changes for the worst were in fact the most prevalent.
- The above finding is indicative of a sector in which employment is typically transient and rates of labour turnover are high, something that is supported by other research.<sup>109</sup> However, considerable variation between factories is evident, with factors such as size, structure and product and market mix all influencing the degree to which firms were exposed to the crisis.<sup>110</sup>
- Although net unemployment rose during the study, relatively few of the originally unemployed remained jobless (just 7.6 per cent). A number of explanations

<sup>108</sup> This correlates well with industry-wide estimates of job losses in the garment sector, which have been placed at between 15 and 20 per cent of the peak workforce since late 2008.

<sup>109</sup> See USAID, 2005 and Ear, 2009, for examples.

<sup>110</sup> Similarly, only a sixth of workers actually remained in the same job throughout the study; this may have been larger had the study continued for longer than six months. In this sense, the limited observation period of the research makes for a relatively weak gauge of employment stability in the industry.

for this are possible, but most compelling is the fact unemployment is simply untenable for most workers. Although better paid than many employees in both the formal and informal sectors, garment workers remain overwhelmingly poor and often grapple with monthly shortfalls when trying to cover basic expenses. Consequently and in the absence of social support from the Government, few are able to amass sufficient savings to guard against unforeseen shocks. Previous research has found that female garment workers are able to finance just a month of unemployment before having to either borrow or return home.<sup>111</sup> What's more, as joblessness continued, workers were found to be more likely to accept lower-paid and more risky jobs, including those that expose them to the risks of human trafficking and labour and sexual exploitation.<sup>112</sup>

- Findings from workers suggest that on the issue of lay-offs, factory-level compliance with the labour law was poor. At the outset of the study, only a third of unemployed workers who had been entitled to lay-off compensation actually received it. By the final tracking stage, this figure had fallen to zero.
- On termination notice, factories performed somewhat better. Even though only a fifth of workers entitled to advance notice (of their retrenchment) received it as of the benchmarking stage, this situation improved to 60 per cent by the end of the study. Nevertheless, in both cases (compensation and termination notice) the evidence suggests significant room for improvement to ensure that labour inspection mechanisms are in place and, where necessary, strengthened to prevent backsliding on legal obligations during times of economic distress.
- Job-seeking strategies for most workers were rudimentary. The most common were speculative visits (riding around town asking for opportunities at factories) and word-of-mouth recommendations from friends. Surprisingly few workers used other means to find a job. In most cases also, workers complained that job searching was expensive, leaving many inclined to take jobs with lower earnings and poorer conditions than they would have otherwise accepted. Although state-funded employment services are currently being developed, at the time of the study few workers had even heard that such services were available, let alone consulted them for assistance in finding a job.

111 ILO/CIDS, 2009. In the workers' survey, male workers questioned revealed far lower capacities for saving, with most having only enough for just five days of unemployment.

112 *ibid.*



- Despite ongoing difficulties in the factories and long, arduous working conditions, the majority who were retrenched still wanted to return to this type of work. Most targeted their job search exclusively in the garment sector. By the end of the study, 83 per cent of the ex-factory workers seeking new employment were looking specifically for factory work.



- Although there were widespread concerns about retrenched workers moving into more vulnerable types of employment, the worst scenarios were largely averted. For example, while movement of ex-garment workers into direct and indirect sex work was certainly observed during the crisis, the magnitude of this movement seems to have been smaller than some had predicted. Under-reporting notwithstanding (for reasons of fear and shame, it is perhaps understandable that women working in such occupations may not disclose this information), research has shown a greater proclivity for women to seek work in other factories or to return to the provinces rather than to switch immediately to this type of work. For those who did, NGOs in particular responded by expanding existing programmes to provide information and outreach services to newly vulnerable women, particularly in terms of sexual health services.
- During the crisis, families of both employed and unemployed workers sent additional household members – typically a female sibling of the main worker – into the labour force to search for work. For families of the employed, the proportion using this strategy remained fairly consistent throughout the study, roughly one in eight families. Among the long-term unemployed, however, it peaked in the latter stages when the primary coping strategies were exhausted. By the final tracking stage, nearly a third of families of the long-term unemployed had sent additional family members to seek work. In almost all cases, added workers sought new employment in the garment sector. This reflects both the absence of broader labour market knowledge and the general perception that for low skilled women, garment factory work is one of the easiest urban jobs to obtain.







Managing the crisis

5

## 5.1 Introduction

As the economic crisis took hold in Cambodia, the garment manufacturers became increasingly vocal for government action to address some of the most serious impacts. During the annual Government-Private Sector Forum (G-PSF),<sup>113</sup> manufacturers highlighted a range of concerns that, broadly categorized, reflected a combination of short-term financial worries and more long-standing issues related to industrial structure and competitiveness. In almost all cases, the economic downturn was considered to be a key factor in the emergence or intensifying of these problems. Accounts of the G-PSF discussions not only provide useful insight into sector sentiment during this time but they also give some measure of the Government's responsiveness to its various demands.

Beyond the G-PSF discussions, employers' organizations, trade unions and society actors struggled to develop concrete action plans and meaningful responses to mitigate the effects of the economic crisis, which unfolded rapidly and affected a large number of enterprises, workers and indirect service providers dependent on the industry.

## 5.2 How did the Government respond?

### *Fiscal policies*

Expansionary fiscal policy was one set of measures proposed by the garment manufacturers to offset the financial burdens they were facing amid the rapidly tightening external trade environment. Central among these was a call for a temporary suspension of the 1 per cent "advance profit" tax for enterprises (measured as a percentage of their monthly turnover), which GMAC argued was necessary to arrest the growing trend of factory closures and mass lay-offs in the sector. Following extensive discussions, the Government heeded this request, waiving the tax until December 2012. In addition, it also responded to calls for a temporary reduction in employer contributions to the National Social Security Fund, cutting the rate by 0.3 per cent to 0.5 per cent for the garment, footwear and supporting sectors until 2010. Both these measures formed part of a broader expansionary fiscal stance adopted by

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<sup>113</sup> The G-PSF was created in 1999 as a personal initiative of the Prime Minister Hun Sen aimed at facilitating discussion and consultation between the private sector and the Government on a range of issues related to private sector development policy. It has been supported by the International Finance Corporation of the World Bank since 2002.

the Government in 2009, when estimated total expenditures rose to 17.6 per cent of GDP (from the budgeted allocation of 16.1 per cent)<sup>114</sup> and a widening of the budget deficit, to around 6 per cent of GDP (from a target of 4.2 per cent).<sup>115</sup>

Although Cambodia's use of tax relief was broadly in line with the approaches of many other countries during the downturn, economists differ over their practical utility as a fiscal response. While proponents argue that they are an easily implemented and targetable means to achieve short- to medium-term development aims, detractors contend that for every positive impact, there is often an equal or larger negative consequence, most commonly through revenue loss and distortionary effects.<sup>116</sup> This same debate has played out in Cambodia in the context of the global economic downturn, with a number of commentators suggesting that rather than using tax cuts, the Government could have better served its economic and social goals through a combination of tax credits for investment and in-house training courses in the factories. This way, they argue, manufacturers would have had greater incentive to retain and invest in existing staff during the crisis rather than using tax savings – as many did – to offset short-term financial woes.<sup>117</sup> Despite this and perhaps understandably, employers generally approved of the Government's measures, noting that although their precise impacts were uncertain, the tax cuts were both swiftly delivered and aptly suited to the industry's immediate needs.

### *Trade facilitation*

Garment manufacturers also called for a number of trade facilitation and enhancement measures, most of which centred on streamlining official procedures, increasing fee transparency and clarifying and amending garment-related import and export regulations. Compared with the volume of requests, however, the Government offered only partial concessions, the most notable being the decision to cut export management fees by 10 per cent (garment sector only) and simplify customs clearance procedures for returned goods.<sup>118</sup> Proposals to reduce customs clearance charges, to amend regulations on customs brokers and to simplify border clearance procedures for goods traded within ASEAN were also advanced during these discussions. However,

114 ADB, 2009: 200.

115 The 2010 budget seeks to partially withdraw this stimulus to ensure fiscal sustainability, although the Government is aware that with economic recovery still far from assured, this will likely be a delicate task.

116 See for example, Klemm and Parys, 2009.

117 Jalilian and Reyes, 2010.

118 Return of goods was a normal and expected part of the garment trade, GMAC had argued, hence the need for simpler official procedures.

given that many of the issues raised were in fact long-standing ones that pre-dated the crisis, it is likely that the Government will have to return to them in the near future as it tries to reposition Cambodia on a more sustainable growth trajectory.

### *Re-training laid-off workers*

Employers in the garment sector also demonstrated concerns about the employment impact of the downturn; they appealed for government intervention to alleviate the hardships of newly laid-off workers and facilitate their swift transition back into work. Measures to link vocational training with the newly retrenched workforce and, simultaneously, to private sector needs was one proposal aimed at achieving these goals. In addition, recommendations were also made to link specific training with microfinance and small business training so as to provide workers with opportunities for income generation beyond traditional wage employment, the opportunities for which had shrunk markedly during the downturn. This aligned well with broader government thinking and initiatives in the training sphere, which placed heavy emphasis on the role of entrepreneurship and self-employment – alongside agricultural work – as a mechanism to tackle the country's growing unemployment challenge.

In response to these recommendations, the Government agreed to convene a series of donor-backed workshops in early 2009 to map out the details of the training initiatives to be unveiled. Although it appears such workshops did not actually materialize, attention can be drawn to other government initiatives announced around the same time that had a specific or implicit focus on the garment sector. The Prime Minister's Special Fund, launched in spring 2009, was perhaps the most high profile of these. This was a short-term programme worth around US\$6.5 million and designed to provide retraining and re-employment pathways for retrenched workers and unemployed youth affected by the economic crisis. Through the programme, a series of state-subsidized technical and vocational short courses were offered across various subjects, including sewing and tailoring, agricultural skills, electronics, motorcycle repair and air conditioning maintenance – subjects already widely provided but deemed relevant to market need.<sup>119</sup> Just over 40,000 people were reported to have completed those courses between May and November 2009, more than half of them women.

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<sup>119</sup> Students received a daily food allowance of \$1 and a monthly accommodation stipend of \$10 while enrolled in a course.

Of the 40,140 recorded beneficiaries of the programme, 36 per cent were categorized as retrenched workers and the remaining majority were unemployed youth, which in the absence of an accompanying definition implies the inclusion of school drop-outs who had yet to join the labour force.<sup>120</sup> The speedy implementation of this scheme created challenges in the extent to which the courses offered actually reflected labour market need and on how to ensure appropriate targeting so that the courses could indeed reach their targeted beneficiaries – female garment workers.

The Special Fund initiative is illustrative of the Government's awareness of the mounting unemployment problem during the economic crisis and the need to increasingly attend to employment creation through investment in skills development and vocational training that reflects more equitable economic and social development. Whether or not this initiative came about as a response to industry demands per se is debatable because the extent to which factory managers really pressed for such interventions is unclear. Although it was raised as an issue at the Government-Private Sector Forum, logic would suggest that from a manager's perspective, securing concessions for the factory in trade facilitation and tax policy, for example, would take precedent over efforts to obtain training and re-employment for laid-off workers.

Ostensibly, the Special Fund was aimed also at delivering core knowledge and skills for small business ownership, the intention being that many graduates would go on to establish successful business activities on their own or in partnership with others. Hence, for selected graduates, the Government also announced a \$1 million fund to be used to provide microfinance for small business start-ups. Owing to the absence of any formal review or evaluation process for the scheme or of monitoring graduates, it remains impossible to determine the relative performance of these provisions.

Similar to other industry concerns during this time, problems relating to training largely reflected those already pre-existing in the Cambodian economy and labour market. Garment employers and others bemoaned the lack of industry-relevant training in the country as well as the related capacity constraints of the technical and vocational education and training (TVET) system in both training design and delivery. Cambodia's TVET system has long been considered an obstacle to labour market efficiency and economic competitiveness; repeated efforts, often led by donors, have tried to meet the challenge of how to better attune labour force skills with the

<sup>120</sup> ILO field visits conducted in mid 2009 appear too to verify this; a large proportion of students observed in the courses at several institutions were noted as recent school leavers or drop-outs rather than newly unemployed workers.

needs of the labour market. That these issues were again raised during the economic downturn is thus no surprise, although one could argue that addressing them would be an even greater challenge, given the country's new fiscal context and the general slowdown in new private sector recruitment. Despite this, there are efforts currently to improve labour market skills matching through a network of employment service centres (or job centres), of which there are currently four.<sup>121</sup> While the influence of these centres over skills development policy remain currently limited, the prospects for such will improve as labour market information is improved (through local and national collection and analysis) and links between employers, workers and training institutions are established.



Possibly with this longer-term reform prerogative in mind, garment and other employers highlighted the need for new government-private sector initiatives in the training sphere, which would include closer involvement of businesses in the design and delivery of technical and vocational training (through public-private partnerships, for example) as well as moves towards standardized curricula for certain job-based training courses. On the whole, the Government was receptive to these recommendations because

they were broadly in line with its long-term vision for TVET reform. But perhaps because of this long-term focus as well as the unprecedented fiscal constraints the Government was facing at the time, the short-term imperative for action in this area appears to have been difficult to act upon as a response to the crisis. As economic growth returns, it is likely that the long-term TVET reform agenda will resurface, although progress is likely to be slow without substantial levels of donor support.

Despite this, the Government did make several important proposals that could be initiated in the immediate term, such as the formation of a government-private sector task force to examine issues of TVET reform and a new training centre to improve skills matching in the tourism sector. Moreover, specific requests relating to the garment sector included income guarantees for workers and productivity-enhancing and job-seeking measures within the factory. To what extent these measures will materialize in the aftermath of the economic crisis remains to be seen.

<sup>121</sup> With the help of the ILO, the Government has established centres in Phnom Penh, Battambang, Siem Reap and Kampot. Although there are plans to roll out the initiative to all provinces, progress is likely to be slow without additional external donor funding.



### **Box 5.1** **Special initiative for social protection for garment workers**

Through its Better Factories Cambodia programme, the ILO has established a special component on social protection for garment workers, which provides a broad range of services in selected provinces covering the life cycle of a factory worker. The project contains three components:

- i. **Pre-industry training programmes** for young people intending to migrate from local areas to Phnom Penh.
- ii. **Health clinics (infirmaries)** in 20 garment factories that provide prevention and education health services (for reproductive health care, breastfeeding, HIV and AIDS) and overall awareness raising on health issues.
- iii. **Post-industry programmes** to enhance employability and skills of ex-garment factory workers who are willing to develop economic activities in agriculture or micro-enterprises (selected provinces). This component is carried out in partnership with NGOs, women's development centres and commune councils.

The new social protection initiative is a complementary programme of the Better Factories Cambodia working conditions improvement mechanism and aims at bringing attention and implementing practical measures to enhance the overall well-being of the industry's mostly female workforce.

### ***Extending social protection to the poor and vulnerable – the National Social Protection Strategy***

The global economic downturn, and the food and commodity price crises that preceded it, had a significant impact on the poor in Cambodia, and as such prompted the fast tracking of the Government's national plan for social protection. The National Social Protection Strategy for the Poor and Vulnerable (NSPS-PV) was developed under the coordination of the Council for Agriculture and Rural Development and was officially adopted in March 2011. It aims to extend better access to health care (notably through health equity funds), provide minimum income support and job opportunities to the working-age population (through public works programmes and vocational training) and safeguard access to education and food security for poor children through conditional cash transfers and school feeding programmes.

The strategy follows a two-stage process: i) a pilot-testing phase is being conducted (2011–2015), during which existing social protection programmes will be expanded and a coordination mechanism devised at the national and the decentralized levels



(commune councils, districts, provinces); and ii) the development of an implementing plan that is based on the experience gained during pilot-testing and the subsequent roll out of programmes.

Although it is too early to speculate how many garment workers will benefit from this strategy, it is likely that many families of garment workers will stand to gain from the new initiatives launched in the rural areas.

### 5.3 Responses by employers' and workers' organizations

Although employers' and workers' organizations struggled with the fast-moving events affecting the industry, both set up a series of training and advisory services for their members to assist them in dealing with the crisis impacts. Unions were provided assistance from donors, including the ILO, to train their members on the rules and regulations pertaining to retrenchments and bankruptcy. A series of training sessions on how to deal with suspensions and termination and how to set up and participate in responsible transition processes were organized. All in all through 2009, 68 union leaders were trained in two sessions. An inter-union workers' rights support network was also organized, aimed at creating internal relationships among the unions responding to the economic crisis.

For employers, CAMFEBA organized with ILO assistance a series of orientation sessions for its members, developed guidelines on how to deal responsibly with suspensions, retrenchments and closures and offered advisory services through a help desk.

### 5.4 Responses by civil society organizations

The bulk of the civil society response evolved around looking at how to use existing skills development services to accommodate retrenched garment workers. A series of meetings were organized in late 2008 and early 2009 to establish an alliance of NGOs to coordinate referral and service delivery to workers in need of new employment and skills. Some NGOs expressed concerns, which the ILO and other UN agencies shared, about the potential increased flow of women garment workers into vulnerable

employment, such as direct or indirect sex work.<sup>122</sup> Although sample-based surveys confirmed such movements were taking place, little evidence was found to suggest any major or large-scale migration of garment workers into sex-selling activities.

The informal NGO Alliance developed a telephone helpline that garment workers could call and obtain information about available skills development services. This helpline operated from mid-2009 to early 2010 and serviced hundreds of workers. The number of placements was limited because personal situations, their mobility and logistical challenges deterred many workers from taking advantage of the training opportunities.

Although the scale of these efforts was quiet small, they demonstrated a real attempt by civil society to reach out to the garment workers to address their increased vulnerability and opened up a positive debate about the need to further coordinate and harmonize the approaches used by various NGOs in their skills training and jobs placement schemes. Ultimately, for these NGO services to be more tuned in with emerging labour market needs and to achieve the quality necessary for emerging service and industrial sectors, government oversight is critical, with the use of professional competency standards, appropriate accreditation and certification schemes.

## 5.5 Industrial relations and social dialogue

### *Industrial relations*

Although industrial relations in the garment sector have come a long way since the 1990s, the overall environment remains chaotic and oftentimes conflicting. Before the full extent of the economic crisis in the country was known, concerns had already been raised of a possible new outpouring of labour unrest in the sector, fuelled not by working conditions and wages as was often the case before, but by industry-wide retrenchments and closures.

Although many elements define the industrial relations climate, including the legislative framework, collective bargaining and the right to organize, the most visible measure is the frequency and intensity of strikes. In the year immediately preceding

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<sup>122</sup> The United Nations Inter-Agency Project on Human Trafficking (UNIAP), for example, conducted research into the effects of the global financial crisis on women's working conditions and opportunities in Cambodia in 2009.



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the economic crisis, the number of recorded strikes at garment factories increased quite significantly, from 80 in 2007 to 105 in 2008. This was attributed in large part to the spiralling cost of living, particularly driven by food and fuel price inflation, which resulted in demands for higher wages and benefits. However, as the global economy went into decline and Cambodian factories started to feel the effects, the number of strikes in the sector actually also declined, falling to just 58 in 2009. As previously noted, this may have been a reflection of prevailing union sentiment during this time, which tended to focus on conciliation and non-confrontation with employers for fear of exacerbating an already worsening retrenchment situation. At the same time, official data may have underestimated the extent of industrial action; during this time there were also a number of protests that took place outside newly closed factories – most commonly to demand unpaid severance pay and lay-off compensation. Such protests were not all captured in official strike data.

Interestingly, the ILO enterprise survey findings suggest that of those strikes that did occur during the downturn, relatively few were considered to be a direct consequence of it. Indeed, nearly a fifth (17 per cent) of the factories surveyed experienced strikes in the 12 months prior to September 2009; of them, only a quarter were deemed by employers to be directly related to the economic situation. More commonly, it was noted, they had arisen out of personal differences between workers (and workers' representatives) and management over compensation issues as well as differing

interpretations of the labour law. While such findings are both inherently subjective (they represent the views of one particular group) and potentially under-reported (some employers may have been reluctant to acknowledge the links between the crisis and their own factory's situation), they are nevertheless indicative of the general industrial relations context during the crisis. They also lend weight to the conclusion that despite earlier fears, the economic situation did not have a major adverse effect on the prevalence of industrial action.

Although the strike situation was less severe than many expected, employers did not stop pursuing their industrial relations policy objectives during the downturn. Accordingly, GMAC addressed the Government with demands for stronger enforcement of the labour law regarding union activity, particularly on the use of arbitration for dispute resolution. Few, if any, strikes in the garment sector follow the basic legal procedures of conciliation and arbitration, prior to a strike vote and due notice to the employer and the MOLVT, and this trend continued throughout 2009 and 2010. Some employers claimed that stronger enforcement of the law was needed to mollify union-led unrest during the crisis, but the fact that strike activity actually declined during this time suggests that the need for such enforcement was actually no more intense during the crisis than it had been before.

Employers also called for stronger enforcement of the labour laws and better accountability by union leaders.<sup>123</sup> Again, given the lack of credible evidence to the contrary, this appears to have been more a revival of a long-standing complaint (that some unions do not follow the labour law) than a response to a specific deterioration of the situation during the downturn. Garment manufacturers requested the MOLVT to issue a specific prakas (a ministerial proclamation) to press all unions to follow the law and called for explicit mention in these documents of the sanctions that would apply in the event of non-compliance. Currently, a specific trade union law is at its later stages of development and is expected to be ready for approval in late 2011. In theory at least, the law is intended to improve industrial relations by better regulating the activities of unions and employers' organizations, promoting union representation and encouraging collective bargaining.

With good reason, unions opposed the implication made by employers that strikes were responsible for the mounting closures in the garment sector; they instead pointed to the poor external trade climate stemming from the global downturn as

<sup>123</sup> These issues were raised at the Government-Private Sector Forum in 2009.

the determining factor. Citing official statistics on strike reductions, the Government agreed with this view and consequently ruled out further discussion as well as legal enforcement issues.

## *Social dialogue*

The history of conflict and mistrust between garment sector unions and employers shaped the nature and direction of social dialogue during the crisis. To an extent, the economic decline masked what had been an improving overall relationship between unions and GMAC in the preceding years – a period that had been marked by a number of successes, including the renegotiation of the minimum wage (in 2006) and the commencement of regular union-employer dialogues from 2007 onwards. The latter continued into 2008 and 2009 and have since been credited with helping appease both sides and moderate labour unrest in the sector.



At the same time, the crisis highlighted the need for stronger mechanisms for social dialogue in Cambodia, including not just improvements to the long-term regulatory framework but also the creation of regular discussions on issues of mutual importance. In one example (but one that has not been permanently institutionalized as a regular feature of the social dialogue calendar), representatives from trade unions, employers, Government and civil society met in 2009 to discuss collective strategies to improve workplace cooperation and industrial harmony

beyond the crisis. The meeting, organized by the Arbitration Council Foundation, centred on safeguarding enterprise and job growth in the sector in the future and developing strategies to improve global competitiveness.<sup>124</sup> Strategies agreed upon included stronger workplace cooperation and improved systems for regular social dialogue, early crisis warning systems and common procedures to resolve existing or potential workplace grievances.

## 5.6 Concluding remarks

Lacking the fiscal space to replicate the stimulus packages offered in other Asian countries, Cambodia's response to the economic crisis was predictably limited and consisted mostly of ad hoc and small-scale efforts targeting specific at-risk groups.<sup>125</sup> Although the Government presided over a modest rise in total expenditure, from 16.1 per cent to 17.6 per cent of GDP, it is likely that the impact on the economy generally and on poverty reduction more specifically was undermined by targeting deficiencies.<sup>126</sup> As the hardest-hit economic sector, the garment industry was singled out for special assistance, with measures centring mostly on short-term tax relief and trade facilitation. There are doubts, however, that the government response achieved its objectives.

Despite clear budgetary constraints, Cambodia has some well-developed institutional mechanisms to resolve collective action disputes and other issues of concern in the garment sector. For example, the formal settings of government-private sector dialogue are relatively well institutionalized, which meant that during the downturn it was relatively easy for the Government to canvass the views of industry leaders on appropriate policy responses in certain sectors. The tax relief and trade facilitation measures in the garment sector emerged out of precisely this type of process. While these measures demonstrate clear government responsiveness to private sector requests, the same cannot be said for all issues raised at that time. On demands that were deemed to have little connection to the economic crisis as well as those pertaining to apparently long-standing and structural concerns, policy-makers tended to defer

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<sup>124</sup> The Arbitration Council is an independent body established in 2003 to resolve collective labour disputes in the garment and other sectors. A statutory body that is genuinely independent of the State, the Council has heard over 800 cases since its inception and has successfully resolved nearly 70 per cent of them. The Arbitration Council Foundation is a local foundation established in 2004 to support and facilitate the work of the Arbitration Council. Many of the issues raised in this meeting were later addressed in what became known as the MOU on Industrial Relations in the Garment Sector, which was established in late 2010.

<sup>125</sup> UNICEF, 2009

<sup>126</sup> ADB, 2010: 200



decisions and proactive responses until a later date. This may have been an expression of pragmatism and prioritizing during a period of mounting budget pressures. And it may also be suggestive of the implicit view that long-standing concerns would outlive the crisis anyway, thus negating the need for short-term consideration.

On balance, the responses adopted in the garment sector were logical and well meaning, with clear attempts made to provide targeted assistance to both garment enterprises and their workers. Assuming the views of GMAC as indicative of wider industry sentiment (from the employers' side), it appears that employers were generally positive about this, concluding that amid intense competition for sector-specific crisis spending (from the State), their sector had been a primary beneficiary of the Government's crisis response. To a large extent, this appreciation seems to have been more a product of modest expectations than of the demonstrated success of the measures themselves. Indeed, with their relative performance still unmeasured, the assistance provided to the sector has been more often judged against government capacity to deliver than a vision of an ideal response.

Although justifiable in the earlier economic context, the deferral of efforts to address long-standing concerns will become increasingly untenable in the post-crisis era. Several of these concerns, including those relating to industrial relations, skills development and trade facilitation, represent critical impediments to the industry's future success, affecting not only economic competitiveness but also the country's reputation as a global sourcing destination for apparel. With the industry now at a mature stage of development and re-entering a more fiercely competitive global market, it is unlikely that it will see the same unprecedented growth rates that it did in the early part of the previous decade. Addressing these challenges in the coming years will not only help the garment sector offset the fierce competition by introducing new means to generate growth (albeit likely at much lower annual rates than it once enjoyed), it will help facilitate the transition from the previous, highly vulnerable growth model to one that is both more sustainable and better equipped to withstand externally driven crises.

More still needs to be done to sustain continuous improvement in labour standards and working conditions in garment manufacturing and for the emerging industrial relations advances to be internalized by the industry. In particular, the sector needs to continue to work towards more effective use of the existing dispute resolution, conciliation and arbitration mechanisms and to further develop existing social



dialogue mechanisms at the enterprise and sector levels. This is imperative not only for furthering future garment sector investment but also to assure possible investors in other industrial sectors, such as footwear and light manufacturing, to gain markets from competitors, such as China and Viet Nam, that are also facing increased wage levels and competition for skilled workers.

Unions and employers in the sector took up this challenge in 2010 by agreeing and signing a Memorandum of Understanding on Industrial Relations in the Garment Sector. Negotiated between six garment confederations and GMAC, the MOU is a package of commitments that the parties agreed to implement. These range from compliance with the labour laws to collective bargaining by most representative unions and non-interference in that process by minority unions. Perhaps the most important element is an agreement by unions not to strike prior to conciliation and arbitration in exchange for employers' commitment to agree to binding arbitration for rights disputes. After a few months of initial adjustment following the signing in September 2010, the impact of the MOU has been demonstrable. The incidence of strikes has decreased by more than 50 per cent against historic averages (19 in the first six months of 2011), while the first-quarter rate of binding awards is at 54 per cent. Current performance is no guarantee of future success, but the rapid improvements, especially in light of the difficult history, are encouraging.

### **Box 5.2** **Monitoring and supporting factories amid the downturn**

The Better Factories Cambodia (BFC) programme, with support from the Government, unions and employers, provided a lengthy menu of training and capacity building services to the industry during the economic crisis. Through its reporting on working conditions and its highlighting of emerging issues, the BFC monitoring provided the industry with a wealth of information on gaps in compliance and on improving working conditions and productivity. By providing information on working conditions and on the impact of the economic crisis directly to buyers, it allowed them to support various improvement processes on the factory floor. Importantly, the BFC assessed the impact of the crisis on the garment sector through various studies that informed the bulk of this book. Resources were also allocated directly to unions and employers to advocate for appropriate policies and for improving industry understanding of the laws, such as concerning retrenchment.

The BFC synthesis reports on working conditions in the export garment sector (derived from monitoring visits) continue to provide valuable information about trends in compliance with labour laws. The series of reports on working conditions that cover the period of the economic crisis can be accessed at: [www.betterfactories.org](http://www.betterfactories.org)

### **Box 5.3**

#### **Institutionalizing good industrial relations**

There was some progress in improving industrial relations and social dialogue during the crisis. GMAC set up regular meetings with all national trade unions every four months to discuss significant issues related to the garment sector. The issues included factory-based problems, such as workers' complaints over working conditions. Unions too have used better methods to express complaints by pushing for comprehensive collective bargaining agreements.

The ILO Labour Dispute Resolution Project was established to help institutionalize a more efficient and harmonious system of industrial relations in Cambodia. A system for determining a union's most representative status at the enterprise level was created, and the project assisted in a significant increase of unions with that status: an average of nine per year between 2004 and 2006, rising to an average of 35 per year between 2008 and 2009. The ILO also assisted in the negotiations of collective bargaining agreements.

At the enterprise level, some factories established policies that have contributed to improved dialogue and industrial relations:

- There has been an increase of factories providing orientation training to newly recruited workers on their rights and entitlements under the labour law.
- Some factories have increased wages to \$70 a month and others are paying a high attendance bonus of between \$10 and \$18, compared with the \$7 required by law.
- Factories now provide \$6 monthly meal allowance for overtime hours and a \$5 lunch allowance.
- Probationary workers receive the same wages as those of regular workers, even during the training period.



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# 6

Looking ahead

## 6.1 Introduction

In Asia and elsewhere around the world, low-technology and labour-intensive industries have often formed the first step on the path to industrial development. Arguably the best examples of this can be found in the rise of the East Asian Tigers (Hong Kong (China), Republic of Korea, Singapore and Taiwan (China)), all of which used export-oriented industries, such as garments and textiles, as a springboard to higher-value, more sophisticated industrial products. In addition, more recent but less dramatic examples are found in some of the region's current middle-income countries, including China, Indonesia and Thailand, which after an initial high reliance on garments have now developed more diversified and high-tech manufacturing bases.

For the East Asian Tigers, industrial growth started to gather pace in the mid-1960s, amid an influx of foreign direct investment and substantial mobilization of domestic labour and capital. After an initial concentration on labour-intensive export industries, these countries, in a relatively short time, accumulated enough capital and established strong enough infrastructure and skills bases to begin a transition to higher-value, more sophisticated types of manufacturing – of machines, electrical equipment and electronics, for example. Although more capital intensive than their predecessors, these industries still had considerable labour reliance but this time in relatively higher-skilled occupations.<sup>125</sup> Today, after more than four decades of industrial growth, these countries have now entered a post-industrial phase, characterized by declining industry shares in employment and GDP and the diversion of new manufacturing investments to newly emerging Asian economies.

For Cambodia, with its abundant low-cost labour and a liberal, if not altogether simple, investment climate, a similar garment-led export model seemed a natural course for its early post-war development. Having entered global production later than most, the country's garment sector was given an early boost by the favourable international trade context (specifically, its lack of Multifibre Arrangement quota restrictions) and later by specific trade concessions that improved Cambodia's access to lucrative foreign markets. As the sector developed and Cambodia assumed its place among the top US garment suppliers, there appeared parallels with the experiences of earlier East Asian garment exporters. Although probably not central to policy-makers' early considerations,

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<sup>125</sup> UNIDO, 2006; USAID, 2006: 1.

there was valid reason in Cambodia to suggest that garment manufacturing could be important not only in terms of employment creation and poverty reduction but also as a conduit for wider industrial diversification and upgrading.

## 6.2 Cambodia's challenges and opportunities in garment production

In Cambodia, the Government did not adopt a strong industrial promotion policy for the garment sector but did indeed provide an environment friendly to foreign investment. Growth was driven largely by foreign investors and expertise, many of which originated in countries with long experience of garment production and the transition to higher-value forms of manufacturing.<sup>126</sup> Cambodia differs from the earlier East Asian garment producers, which though not homogenous in their approaches generally pursued more state-centric, interventionist models of industrial growth (albeit aided by substantial foreign investment). By contrast, the role of the State in Cambodia has remained fairly limited throughout the sector's growth, providing what might be termed the "bare essentials" for industrial development: political and economic stability and a (relatively) favourable investment and regulatory climate.

In Cambodia, garment manufacturing has managed to thrive despite a generally poor governance environment.<sup>127</sup> Part of this is due to the specific nature of modern garment manufacturing, which in its developing-world production bases can operate largely irrespective of the local economic and political contexts. In Cambodia, this is made possible by the sector's non-local character: aside from its labour reliance, garment production displays little real reliance on Cambodia itself, since the bulk of investment, inputs and customers are foreign. In a country in which weak and ineffective governance has been cited as a major drag on public service provision and national competitiveness, this may have been to the sector's advantage.<sup>128</sup> In addition, basic conditions provided by the State – political and macroeconomic stability and a liberal investment climate – have been complemented by sector-specific governance arrangements involving the Government, employers, international buyers and the ILO. By identifying key actors and creating organized channels for dialogue (such as the Government-Private Sector Forum), these arrangements have been successful in

<sup>126</sup> Singapore, Hong Kong (China) (China) and Taiwan (China) are three such examples.

<sup>127</sup> World Bank, 2009: 22.

<sup>128</sup> Governance in Cambodia is by almost any internationally recognized measure poor. For example, the country ranks low (and often lower than countries at the same level of development) on measures relating to the rule of law, corruption and perception of corruption, political freedom and doing business (see World Bank, 2009 for links to evidence).

circumventing governance flaws and generating an environment that is conducive for the garment industry's growth.

Because of its foreign ownership, export focus and concentration on only simple value-chain functions, Cambodia's garment sector is not firmly embedded in the domestic economy.<sup>129</sup> This raises several concerns that have implications for both the sector and for future industrial development. First, it is clear that links between the garment sector and other parts of the domestic economy are weak – a situation not helped by the fact that most factories are operating at the cut-make-trim stage of the value chain. Second, and linked to this, the industry imports the vast majority of production inputs from abroad.<sup>130</sup> Third, it has been argued that foreign investors are only weakly inclined to invest in the addition of the domestic supply chain links needed for industrial upgrading and development.<sup>131</sup> This follows on the premise that unlike foreign investors, whose presence is typically short-term and conditional on factor costs, locals actually have a long-term vested interest in the country's industrial development. Given all these conditions, some analysts conclude that Cambodia lacks the solid foundation for real industrial upgrading.<sup>132</sup>

The absence of strong roots may make already “footloose” garment factories even more sensitive to changing economic and trade conditions. As Heintz<sup>133</sup> notes, this raises important questions over the long-run sustainability of the employment opportunities and human development improvements associated with the growth of the industry. Moreover, doubts also arise over the extent to which Cambodia can use garment manufacturing as a catalyst for broader industrial upgrading or whether its current institutional and governance set-up, combined with low human capital progress, will conspire to weaken such opportunities.

To date there has been little evidence that the garment sector can provide this spur to higher-value forms of manufacturing.<sup>134</sup> No significant diversification has been evident beyond exports already produced since the mid-1990s,<sup>135</sup> and this has left the country both tied to simple value-chain functions with low value added and reliant

<sup>129</sup> Heintz, 2007.

<sup>130</sup> According to GMAC, Cambodia spent \$800 million importing cloth in 2007, \$531 million of which came from China. In 2008, this rose to \$1 billion (Sopha, 2009).

<sup>131</sup> *ibid*, 2007. Many of these industries (textile production) are more capital-intensive than garment manufacturing and therefore require a more long-term commitment of fixed capital resources, a commitment foreign investors seeking short-run returns may be unwilling to make.

<sup>132</sup> *ibid*, 2007.

<sup>133</sup> Heintz, 2007.

<sup>134</sup> Ear, 2009: 11.

<sup>135</sup> World Bank, 2009.



on a marketplace in which competition has intensified since the end of the quota system. This picture lies in stark contrast to the trajectory followed by the earlier East Asian Tigers, which after establishing CMT operations in the 1960s, moved rapidly through the upgrading process, adding to their repertoire new and more complex supply chain functions as well as entirely new types of manufacturing.<sup>136</sup> Although this is not necessarily the path that Cambodia should or indeed is able to follow, it nevertheless serves to underscore the reality that for as long as the country's product mix remains narrow and productive capacities low, the scope for value chain upgrading, technological transfer and wider industrial learning will also remain limited.

While the experience of the East Asian Tigers still offers useful lessons for industrial upgrading (box 6.1), Cambodia's policy context has shown few similarities to these countries. One difference between Cambodia now and the earlier Asian garment exporters is that industry profits among the latter were invested in the development and upgrading of physical and human capital – something that in a relatively short period of time enabled them to move up the industrial value chain. For a government, this is inevitably easier to achieve if the businesses in question are predominantly domestically owned, which in Cambodia is not the case. Additionally, reinvestment was also coupled with proactive government policies: in Singapore, the State offered incentives to enterprises to innovate with new products. In Malaysia (which is not an original East Asian Tiger but still a more recent good example of industrial upgrading in Asia), manufacturers were given tax rebates if they provided specific training to their workers.<sup>137</sup> Similar approaches were successfully adopted by garment producers from Costa Rica to Mauritius in the 1990s. In Cambodia, however, such efforts have been mostly lacking from the government side, which has preferred to take a back seat to foreign investors in shaping the nature and pace of the sector's development.

Cambodia also faces a much changed international context than its Asian predecessors, and this is something that may hinder its ability to replicate their transitions. The global trade environment today is far removed from that of the 1960s or even the 1980s. In light of the phasing out of the Multifibre Arrangement, the lifting of safeguards on Chinese exports and the emergence of other low-cost world suppliers, it is clear that global competition in garments has become considerably more intense. For the East Asian Tigers, the then-international context was an advantage because

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<sup>136</sup> World Bank, 2009: 17.

<sup>137</sup> UNDP, 2009: 38.



there were fewer competitive export nations in the 1960s and 1970s. Ultimately, these economies did face constraints under the Multifibre Arrangement, but the extent of their impact was minimized by the speed and efficiency of their industrial development (upgrading and diversification).

### Box 6.1

#### Triangle manufacturing: Can Cambodia learn from the East Asian Tigers?

**The global garment sector underwent several major production shifts in the twentieth and early twenty-first centuries:** the first from North America to Japan and the second from Japan to the East Asian Tigers. In later transitions, production migrated to other low-cost Asian bases. An observable and unique feature evident after that time was the continued involvement in global supply chains of the early East Asian producers. This was the beginning of a process known as “triangle manufacturing” in which enterprises began to manage and coordinate processes in the global garment supply chain – receiving orders from developed markets and arranging production for direct export from affiliated factories in low-wage Asian countries.

**Key to the emergence of triangle manufacturing was the shift by East Asian producers from simple garment assembly to a more domestically integrated and higher value-added export model known as full-package supply, or original equipment manufacturing (OEM) production.** This relates to the production of finished consumer goods by contract manufacturers who source the inputs and make the final product to be sold under the buyer’s brand name. East Asian producers learned how to become full package suppliers for foreign buyers, which gave them unique organizational capability for creating and managing supply chain networks across Asia (Gereffi, 1995).

**For producers like Hong Kong (China) and Taiwan (China), much of the basis for this upgrading came from acquired knowledge of organizational supply chain links, established relationships with international buyers and expertise in efficient sourcing practices** (Gereffi, 1999). The knowledge and expertise were “learned” over a period of several decades and were often assisted by proactive government policies to enhance domestic capital accumulation and strengthen workforce skills.

**Due to its foreign ownership and lack of domestic embeddedness (links to upstream- and downstream supply chain activities), present day Cambodia lacks a solid foundation for a similar process of industrial upgrading** (Heintz, 2007: 29). Analysts have argued that the country needs to pursue policies to encourage greater learning, knowledge transfer and domestic investment in supply-chain relationships. Although these can be facilitated in a number of ways, broad policy agendas would likely involve boosting domestic ownership of the industry (perhaps through more joint ventures with foreign enterprises) and intensifying the growth of domestic economic links, both upstream and downstream of the assembly process (ibid, 2007).

Despite this less-favourable environment, this does not mean Cambodia cannot thrive in the global garment trade. Key to this will be diversifying export markets, boosting domestic value-added and encouraging greater local ownership of the industry – particularly from SMEs, which make up the bulk of formal businesses in the country. The prospects in this regard are potentially good. Research from other countries (Kenya and Bangladesh, for example) has shown that contrary to much conventional wisdom, large garment factories (those with workforces running into the thousands) exhibit little in the way of scale economies or efficiency gains over smaller enterprises.<sup>138</sup> Coupled with the fact that labour-intensive industries are naturally more conducive to the entry of SMEs (because labour is typically less difficult and less expensive to obtain than capital for small enterprises) and that significant opportunities exist in today's market, both for smaller volume “niche” production and outsourced “trade in tasks” from other supply chains, there is good reason to believe that with the right incentives, local enterprises could assume a greater role in the future development of the garment sector in Cambodia.

However, like diversification, realizing greater local ownership will not come easily. Arguably the most important current obstacle is the dearth of local management expertise, both now and in terms of future potential managers (e.g. today's students). This deficiency stems from the decimation of the country's human capital base during the 1970s and from the problem the industry has in attracting young graduates into its ranks – a product of the widespread misperception of factory work as arduous, low skilled and low paid.<sup>139</sup> The resulting predominance of foreign managers has a number of implications. It complicates the industrial relations environment (through language barriers and cultural differences), increases costs (expatriates are paid far more) and reduces the prospects of Cambodians assuming the lead in the sector's development. Cambodian factories today are dominated by experienced managers from earlier garment exporters (see figure 3.1 in Chapter 3). However, it's unlikely that Cambodians could rise to prominence in the garment sectors of other countries (Lao PDR or Myanmar, for example) due to their current absence in the domestic management scene.<sup>140</sup>

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138 UNIDO, 2006.

139 This may be true for factory floor work, but salaries for entry-level and middle managers are typically very competitive in Cambodian terms. Among most students, this is either not known or overlooked because the industry is often deemed to lack the prestige of other careers.

140 There is also an equally valid argument to suggest that foreign managers have been good for Cambodia, having not only helped drive the industry's stellar growth but also facilitated critical transfers of knowledge and expertise to the few Cambodians that have worked alongside them.

Much has been said of the need for Cambodia to diversify its industrial base, both within and away from existing sectors. For the garment sector, which still struggles with the same structural weaknesses as it did in the 1990s, this will most likely mean broadening the scope of productive activities to boost value-added capture and expedite industrial upgrading.

Becoming a “full-package” supplier of garments is one strategy to achieve this. Full-package supply would involve producers moving away from simple assembly operations and assuming greater involvement in the management of supply chains at the production stage. Industrial upgrading thus becomes synonymous with and integral to efforts to improve supply-chain efficiency within the country (efforts that also require simultaneous investments in infrastructure and basic economic services). By shifting at least a portion of these functions to local enterprises, Cambodia will thus reap both the benefits of improved value-added (since these functions all generate more value than CMT operations) and the improved environment for industrial learning and upgrading.

In addition, industrial upgrading would also be helped by nurturing the development of domestic links with the garment sector. As Heintz<sup>141</sup> argues, if domestic suppliers of inputs to the sector (for example, in textile production or spinning) were to grow, the potential for building and managing relationships between these producers and clothing enterprises would increase. This would then form a conducive and likely basis for industrial upgrading in the country, through organizational links and special economic zones, for example. The cost savings would be substantial (Cambodia already spends US\$1 billion a year on imported inputs for the garment sector<sup>142</sup>), even if domestic supply was only meeting a relatively small fraction of overall demand.<sup>143</sup>

To encourage those links, which would form part of a vertical upgrading strategy, several policy approaches could be adopted. These include new incentives to encourage more joint ventures between Cambodian enterprises and foreign investors and targeted industrial policies to increase the density of domestic businesses supplying the garment sector.

In addition to vertical upgrading strategies, there are a number of more broadly

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<sup>141</sup> *ibid.*

<sup>142</sup> GMAC figures for 2009, cited in ADB, 2011.

<sup>143</sup> Progress in these areas would be contingent on a number of other factors, including concomitant investments in transport and logistics infrastructure and basic economic services.

beneficial horizontal strategies that may be relevant for Cambodia. These entail policies aimed at boosting the efficiency of supply chains and other productive processes, with benefits for both manufacturing and other economic sectors. Horizontal strategies are ones that are not specifically targeted but aim to improve the general industrial environment along with the conditions conducive to industrial diversification. In Cambodia's case, emphasis should be on both supply chains (since these are currently undermined by various institutional and infrastructure weaknesses) and on non-wage production costs. In terms of wages, which are lower than that of many international competitors, Cambodia is already competitive in international terms.

Several components could be envisaged under horizontal diversification. First, Cambodia needs to improve its basic economic services and infrastructure, in particular the transport and communications network and its energy supply, the low quality and high cost of which remain a major drag on business competitiveness.<sup>144</sup> Delivering this (efforts towards which have already been initiated by the Government) would significantly lower production costs and strengthen the country's position and integration in the global supply chains. It would also attract and sustain foreign investment, which for several of the country's industries is critical to their very survival. In addition, businesses in general would benefit from improved educational standards and market-relevant skills development and training. This includes garment manufacturers, which are not heavily reliant on skilled labour currently (at least at the production level) but would stand to benefit from a greater supply of skills able to produce higher-quality and more design-intensive garments and to adapt to more mechanized, flexible and responsive production processes. Improved skills are also needed at the supervisory and management levels, which although more widely taught today than at previous times, continue to suffer from constraints relating to teaching quality, grounding in basic educational competencies and wider industry relevance.

Other horizontal strategies include efforts to negotiate new trade deals that support national development objectives (including those for the garment sector). The role of the State in supporting the establishment of institutions to promote innovation and diffusion of technological knowledge is critical in this respect.<sup>145</sup> As with economic services and infrastructure, research and development, and education and skills are important prerequisites for remaining competitive in the global market.

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<sup>144</sup> This is an oft-cited concern of businesses in Cambodia and one somewhat reiterated by factory managers questioned in the ILO/CAMFEBA enterprise survey (see Chapter 3).

<sup>145</sup> Heintz, 2007

Cambodian businesses would also benefit from measures to reduce public sector rent-seeking. Survey findings suggest that more than 70 per cent of all enterprises identify corruption as a “moderate,” “major” or “very severe” constraint to growth.<sup>146</sup> Bribes to Cambodian public officials reportedly account for up to 6 per cent of total sales – a sizeable increase in production costs that fare badly against comparable and competing countries in Asia.<sup>147</sup> If such practices were reduced or eliminated, business costs would fall and public sector delivery and accountability may increase. Many of the reforms Cambodia needs to maintain and improve its competitive position in the face of a more hostile trade context depend on a strong State that is capable of delivering in core policy areas.



Analysts have suggested that diversification of a country’s export base comes easier when the new product is “close to” current production structures.<sup>148</sup> Other forms of light manufacturing evident in South-East Asian economies, however, have structures that are typically quite different from those of garment production. This begs a further question of how exactly Cambodia can build on its experience with garments to branch out into new industrial products. Footwear is one industry that is reasonably close to garments but is at the same time far more complex, both in its production processes and its skills and capital

requirements. Needing a more skilled workforce to produce output suitable for foreign markets, footwear manufacturing also commands higher value-added than CMT garment production. This would be beneficial for Cambodia, but its prospects may again be marred by the lack of domestic supply chain links (particularly raw material supplies) and the poor scope for bulk production and scale economies, which are favoured by footwear manufacturers to offset the comparably higher start-up and running costs. Specific steps to encourage the growth of a footwear industry in Cambodia might include promoting specialized economic zones or clusters, using targeted investment policies and human resource and technology policies to attract new, higher-value-added activities.<sup>149</sup>

<sup>146</sup> Ministry of Commerce, 2004.

<sup>147</sup> *ibid*, 2007.

<sup>148</sup> Heintz, 2007; UNDP, 2009.

<sup>149</sup> UNDP, 2009.

### 6.3 Examining Cambodia's niche: Is labour compliance enough?

There are both social and economic rationales to justify good labour standards in labour-intensive manufacturing, even in the world's poorest countries. A commitment to basic labour standards promotes social equity; it helps ensure that the poor and vulnerable get a decent deal in the workplace, with remuneration that befits their effort and working conditions that respect their fundamental rights. Increasingly, especially in light of the visible effects of unbridled capitalism (the global economic crisis, for example), these standards are an expected feature of any responsible strategy for socially inclusive growth and poverty reduction. Labour standards are more akin to passive income-maintenance programmes that buffer the impacts of negative shocks than they are to labour market policies designed to boost productivity directly (such as training and skills development).<sup>150</sup>

In addition to moral grounds, there are strong economic reasons why countries should adhere to certain fundamental or core labour standards. Forced labour, for example, erodes national competitiveness by depriving people the right to choose their employment, develop skills and experience and generate economic value for both themselves and the economy. Similarly, the elimination of child labour is desirable on the grounds that it undermines human capital development, reduces future earnings and contributes to intergenerational transmission of poverty. Of course, in all these cases, the economic rationale for compliance is centred on what is good for society and the economy and is thus of greater concern to policy-makers than individual manufacturers. Still, such standards remain generally uncontroversial and are seldom opposed, at least openly, even in the poorest developing countries.

There is an economic case for labour standards – there is evidence that points to productivity improvements arising from new and refined workplace practices, including performance-related pay, flexi-time, work- and job-sharing and multi-skill training.<sup>151</sup> In such cases, these practices have had positive effects on worker satisfaction, motivation, effort and performance, which in turn have fed into positive improvements to sector productivity and competitiveness.<sup>152</sup>

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<sup>150</sup> Flanagan, 2002.

<sup>151</sup> Gunderson, 2002, in Gunderson, 2005.

<sup>152</sup> Despite the inferred link between these practices and economic performance, conclusive causality between labour standards and productivity is yet to be established in the empirical literature.

The debate over whether adherence to labour standards enriches enterprise competitiveness is long-standing. The primary issue is whether such standards, which range from international labour standards as promoted by the ILO to sector-specific provisions in the national labour law, expand or inhibit productivity, competitiveness and growth.<sup>153</sup> Laissez-faire economic perspectives often contend that labour standards inhibit competitiveness by increasing costs and reducing labour market flexibility.<sup>154</sup> On this basis, some argue that the use of mandatory labour standards in the developing world (such as those in Cambodia) constrains the development of fledgling industries vital to economic growth, in effect “killing the goose that lays the golden eggs”. Linked to this, a common interpretation of developing-world competitiveness is one of a “race to the bottom”, whereby countries strive to keep labour standards low so as to undercut their rivals. This argument stems from the notion of labour standards as a pure cost of production, with no additional productivity or competitiveness benefits.

Some sets of standards are more readily accepted as good for business than others. For example, while occupational safety and health standards are generally lauded for reducing the potentially very high cost of workplace injuries, employment regulations that limit employers’ abilities to hire and fire workers are sometimes viewed as a drag on labour market flexibility and national competitiveness. In most cases, a balance is required between the security of workers on one hand and labour market flexibility on the other.

### *Cambodia: The impact of labour compliance on garment manufacturing*

In the garment sector in particular, there is a popular argument that labour standards are now a mainstream concern in international sourcing. Key to this is the presence of “reputation-conscious” buyers in the global supply chain, a presence that has been on the rise in the global garment sector since the 1990s and that has been an increasingly influential determinant of a country’s market access and export potential. Cambodia’s recent success in the garment trade was heavily influenced by these trends and by its emergence as a destination of choice for “ethical” apparel sourcing. The major development that allowed this to take place was the US-Cambodia Trade Agreement, which ushered in labour standards monitoring by the ILO under the Better Factories Cambodia programme.

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<sup>153</sup> Gunderson, 2005.

<sup>154</sup> *ibid*, 2005.



An oft-cited argument in support of the Better Factories Cambodia programme (and by implication, improved labour standards) is that it has been instrumental in creating a “niche” for the country in the global garment supply chain. Coming at the end of a decade marked by sweatshop scandals involving major global brands, Cambodia’s trade deal with the United States provided an opportunity for reputation-conscious buyers to start afresh in a labour-compliant “safe haven” and demonstrate renewed commitment for corporate social responsibility in garment manufacturing. The value and resilience of this niche has been repeatedly emphasized in light of the industry’s continued (and for many, unexpected) success after the Multifibre Arrangement phase-out in 2005. Before this time, it had been widely predicted that marginal producers like Cambodia would lose out as more efficient producers were finally allowed to trade on equal terms. Following the resumption of quota-free trade, garment exports from Cambodia continued to grow, helping the country consolidate its place as one of the world’s fastest-growing economies and a major source of US garment imports.<sup>155</sup>

**Box 6.2**  
**Are decent labour standards becoming the norm in global garment production?**

It is increasingly true that in modern supply chains, particularly in the garment sector, the choice over whether or not to comply with labour standards lies not so much with the producer but with reputation-conscious buyers.

Companies are responding to consumer sentiment, which in many Western societies has grown in awareness and activism in recent years in support of workers’ rights in sourcing countries.

Major international clothing brands have from the early 1990s established large-scale codes of conduct and compliance audit systems irrespective of national laws or independent monitoring. They often use the national labour law and the international labour standards as the minimum requirement but typically also request manufacturers to ensure a higher standard that covers specific issues, such as safety and health or factory policies.

There is reason to suggest that labour standards are in fact becoming one of several baseline conditions for global sourcing in the garment sector, so much so that it is now becoming increasingly difficult for policy-makers and enterprises to ignore them if they are to secure access to international brands and markets.

<sup>155</sup> That other countries with comparably weaker labour standards also did well during this time suggests that labour compliance alone was by no means the only or necessary factor in ensuring global competitiveness.

## Box 6.3 Costs and payoffs to compliance

Due to the trade benefits under the US Trade Agreement on Textiles and Apparel (TATA), Cambodian garment firms shared a collective interest in upholding a strong record of labour compliance. However, the focus on industry-wide compliance under the Better Factories Cambodia programme created possibilities for free-riding, whereby non-compliant factories benefit from the industry's overall good reputation. One strategy employed to counter this was public disclosure of non-compliance, essentially "naming and shaming" these firms.

This policy ended in 2006, following the Multifibre Arrangement phase-out. Because factories were no longer deriving direct benefits from their labour standards and non-compliance was no longer an offence subject to public disclosure, the expected payoffs to compliance actually fell.

Rather than prompting a wholesale decline in industry labour standards after this time, the role of reputation-conscious (or ethical) international buyers seems to have become all the more important. Such buyers have become more common in recent years, and these companies have continued to demand labour compliance from their sourcing partners, including in Cambodia.

Recent ILO research found that in the post-disclosure era, compliance remained high and most consistent in factories supplying these ethical buyers. Perhaps more surprising, the research also found that among other firms (those lacking ethical buyers), declines in compliance were less severe than feared (and still above pre-BFC levels).

These findings reinforce the conclusion that: i) third-party enforcement complements and stimulates compliance efforts by ethical buyers; and ii) that it can also improve labour compliance among factories with less responsible buyers and those prone to free-riding. The BFC is currently revising its monitoring policies, including moving back towards public disclosure of selected compliance information, as part of working with a global programme called Better Work that has been greatly modelled after the BFC. The Better Work was initiated in 2006 as a partnership between the ILO and the International Finance Cooperation (IFC) and is currently operational in Haiti, Indonesia, Jordan, Lesotho, Nicaragua and Viet Nam (see the ILO Better Work programme for more information).

Source: ILO/Tufts University, 2011

The BFC programme may also have reduced the costs and improved the efficiency of labour monitoring in the garment sector. It could be argued that by implementing labour standards through the conduit of an organized monitoring programme, Cambodia actually managed to reduce the costs of compliance at the enterprise level (ILO monitoring costs less per factory than equivalent audits conducted by

private sector actors). At the same time, it allowed enterprises to avail of a range of management and training services that have delivered further gains in both productivity and competitiveness.

In the sense that labour standards were imposed on Cambodia as a means to secure market access, it is clear that they have been a catalyst for improvements to the industry's overall trade position (*vis-à-vis* key global markets). This is not the same as deducing causality between labour standards and competitiveness. In the case of Cambodia, it was not labour standards *per se* that engendered increased trade but the signing of a trade deal, which was contingent upon the country's labour compliance record. In addition, the fact that labour compliance was imposed rather than voluntary may have constrained the long-term “buy-in” of employers to the notion of continuous improvement in labour standards. Despite obvious gains made during the tenure of the Better Factories Cambodia programme (in terms of working conditions), the extent to which factories would voluntarily choose labour compliance if the ILO was not fulfilling this role remains unclear. Assessments have revealed that rather than valuing compliance on the basis of its intrinsic worth or any perceived business case, factories are often compelled into compliance through the fear of repercussions for not doing so.<sup>156</sup> Under the Better Factories Cambodia programme, retrogression to poor labour standards was deterred by both public disclosure (which ended in 2006) and the presence of reputation-conscious buyers in the market.<sup>157</sup>

As well as enjoying continued trade preferences for garment exports (almost 75 per cent of clothing exports to the European Union, for example, enter without paying a duty as part of the Everything But Arms initiative<sup>158</sup>), Cambodia also enjoys strong buyer good will for its labour standards, which remains an important consideration in international apparel sourcing, even after the economic crisis. In terms of the industry's longer-term sustainability, there remain questions over the viability of labour standards as Cambodia's core competitive advantage in the global garment trade. Indeed, although it is generally expected that labour standards rise in line with greater developmental progress, Cambodia's position as a uniquely attractive garment manufacturer is challenged not only by rising labour standards in other countries but also fiercer competition on other aspects of production in which Cambodia's record

<sup>156</sup> These repercussions were stronger in the early years of the BFC programme when non-compliance was met with full disclosure of a factory's details to local audiences and international buyers. Although public disclosure ended in 2006, the programme includes a so-called “zero tolerance” protocol that allows for serious violation of the labour law, such as child labour and forced labour cases, among others, to be addressed immediately by the relevant authorities.

<sup>157</sup> ILO, 2011.

<sup>158</sup> EU, 2011.

is weak. These include the country's narrow export focus and limited product mix, reliance on foreign inputs, weak trade facilitation, corruption, lagging productivity and volatile industrial relations, all of which may conspire to undercut the advantages the country is able to leverage in the coming years from its adherence to decent working conditions.

## 6.4 The crisis in retrospect: Same problems repeated?

Garment manufacturing will remain an important – if not the most important – source of exports and formal employment in Cambodia for the foreseeable future, a trend that would be consistent with the experience of many other countries at similar levels of development (particularly in East Asia). Current recovery to pre-crisis levels may ultimately be the easy part of the sector's post-crisis evolution. Safeguarding the sector's longer-term economic viability and its continued contribution to Cambodia's economic and human development will mean overcoming a number of important challenges:

1. Remaining competitive in the post-crisis environment, both by improving lead times and becoming a strategic supplier in international markets. Recent trends in global garment sourcing suggest increased competition for rapid and reliable delivery time as well as a trend towards the consolidation of sourcing to strategic suppliers with integrated and more versatile production operations rather than marginal suppliers.<sup>159</sup> It is likely that price competition will continue to be intense, even though it is increasingly suggested that rising manufacturing wages in China will erode its competitive edge. Yet market prices for garments have been declining, indicating increased competition and even greater pressures to lower production costs. Facilitating greater regional trade could help improve lead times and enable Cambodia to meet rules-of-origin requirements for entry to new markets.<sup>160</sup> Further progress in streamlining trade licenses and processes to reduce the uncertainty with turn-around time are also required. To cut lead-time delays and improve the responsiveness of production, Cambodia should invest in local storage of certain types of fabrics so as to keep essential raw materials close at hand (a more radical extension of this would obviously be for the country to actually start producing these inputs domestically).

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<sup>159</sup> World Bank, 2010b.

<sup>160</sup> In some instances this would require garment inputs to be sourced locally too, something that is not the case currently.

2. Better management of factory floor processes and capacity-use rates, combined with more efficient pay incentives, could generate a double dividend. Achieving efficiency increases would require better factory floor management, greater quality control (to reduce waste) and higher capacity-use rates. Such significant gains would come from spreading fixed costs (indirect labour or electricity) over more variable costs. Also important is the progressive remuneration system that is in place.<sup>161</sup>
3. Beyond such improvements, a more radical option for growth and sustainability is sector upgrading. This could come from finding new export markets beyond the United States and European Union (which has only really received serious consideration among policy-makers and the industry since 2007) and by initiating a number of value-adding activities to existing production functions in the country. These include special finishing (such as on jeans) and printing or embroidery (such as on shirts). More radical upgrading would involve structural changes in the value chain (by bringing the designing or financing of products to Cambodia or initiating backward integration by growing cotton and/or setting up textile mills, for example), although the viability of these has been questioned on the basis of economies-of-scale limitations.

Several factors explain why such upgrading has been limited to date: i) radical upgrading is time and capital intensive (including greater demands for electricity) and perhaps this is not in the interest of establishments that use their foreign headquarters for designing, financing, connecting to buyers, sourcing, etc.; ii) Cambodia lacks the economies of scale of China, Viet Nam and other countries that would justify developing value-adding services; iii) even modest forms of upgrading would involve taking greater financial risks (and hence having access to the necessary low-cost capital to finance upgrading, which is reflective of a greater problem in Cambodia and the reason why industrial investment is typically foreign; and iv) this would require managers, to be trained in and have incentives from their headquarters for innovative process controls, instead of being risk averse and focusing on maintaining production levels.

4. Sustaining post economic crisis advances in improving industrial relations is crucial for longer-term gains in supporting further industry growth, particularly

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<sup>161</sup> According to a recent World Bank study (2010), paying workers by the piece and engineering an increase in efficiency from 35 to 55 per cent would: i) bring the average CMT, trade and transport of a pair of denim jeans down from \$1.4 to \$1.2 (a 12 per cent gain) and ii) double operator wages (part of these gains could be expended to free up time for skill upgrading).

concerning the effectiveness of investments in skills development and productivity enhancement. Improvements in the bipartite relationship need to be deepened, with similar improvements to tripartite dialogue. A good way forward in this area has been the industrial relations memorandum of understanding of September 2010, which has continued to build positive trust and confidence for the existing dispute resolution processes through increased binding arbitration for rights disputes. Beyond this, tripartite dialogue on such fundamental matters to the industry as setting minimum wage and bonuses must be improved. The system for setting and reviewing minimum wages should be more systematic, regularly reviewed and based on objective data and clear and agreed criteria. This would help to avoid in the future any large-scale disputes on minimum wage, such as seen in 2008 and 2010.

5. Upgrading would require improving the skill level of workers in the industry and their productivity. Finding skilled labour is not actually a major problem at its current stage of development; but for higher-value goods and markets, the issue of workforce skills development will be critical. In view of the Government's proclaimed policy of economic diversification, attracting more foreign investment and future investments in developing special economic zones require a comprehensive vocational training and skills development plan as part of the broader human capital development strategies currently advocated.
6. The development of an upstream textile industry in Cambodia may improve the sector's economic fundamentals, both in terms of reducing unit production costs (assuming inputs were more cheaply sourced domestically) and lead times, as well as create new job opportunities for thousands more semi-skilled workers. It may also help Cambodia comply with rules of origin requirements in Western markets, while at the same time strengthening economic links in the domestic economy. Owing to the country's generally low productive capacity and the vast economies of scale currently enjoyed by regional textile suppliers (principally China), many people, in the Government and the sector, remain sceptical of the viability of such a proposal. A major additional concern is energy (electricity), which remains both expensive and unreliable and as such a significant obstacle to the growth of new industries as well as access to finance (textile production is typically more capital intensive than garment manufacturing).<sup>162</sup> Although this may improve with upcoming plans to import electricity from Viet Nam, the development of

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<sup>162</sup> Heintz, 2007: 5.

textile production would also require industrial policies that include investment and tax incentives for investors to set up such operations.

7. Proper macroeconomic management is critical to the industry's competitiveness, especially during these times of global economic instability. In response to the economic crisis, the Government has made efforts towards improving its macroeconomic management, including promoting an enhanced business climate by extending the reach of financial services and improving the transparency of the financial system. The Government also finalized drafts of new laws on commercial contracts, finance and insurance and established a commercial arbitration centre. While these adjustments will certainly contribute towards better macroeconomic management, the fluctuations of the real effective exchange rate also need to be addressed. Real exchange rates underwent major fluctuations in 2008, which had an impact on Cambodia's exports. Additionally, inflation needs to be kept in check. The importance of macroeconomic stability and appropriate management of the real exchange rate to maintain the competitiveness of the industry will determine Cambodia's future with garment exports, to some extent.
8. Access to and affordability of credit, which remains a major obstacle to domestic ownership in the garment sector, needs to improve. Looking specifically at the chances of smaller, locally owned factories entering the sector, there are several institutional constraints that may work against such operations in Cambodia. While most of the industry's current factories are externally financed, they still rely on the Cambodian financial sector for short-term lines of credit for working capital. This is not only expensive in Cambodia, where interest rates of 15–20 per cent are common, but also contingent on land ownership, which is used as collateral for commercial overdraft facilities.<sup>163</sup> Given that this is an oft-cited problem even for larger foreign-owned factories, there is unlikely to be much scope for smaller local enterprises to obtain credit if they lease or rent their premises (as is most likely to be the case). This situation stems from wider issues relating to banking regulation that are beyond the scope of this discussion; still, its influence is worth emphasizing because it helps explain the general lack of domestic investment in the economy across all sectors.

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<sup>163</sup> Based on ILO discussions with the GMAC Secretary-General, November 2010.



## 6.5 Concluding remarks

The growth of the garment industry has been the major success story of Cambodia's post-war economic miracle. But in many ways it has been built on foundations that may not be sustainable in the long term. There were a number of factors that were favourable to Cambodia, which was at the "right place at the right time" and thus derived advantages from them. These were business-friendly trade and fiscal policies, advantages created by the former textile quota system and a large pool of low-cost labour. The external factors that drove its development since the late 1990s, specifically the US–Cambodia Trade Agreement and its links to labour monitoring, are less relevant today than they once were because trade is now conducted without quotas and other major producers are improving their product quality and compliance records. And while the special governance arrangements developed since the late 1990s remain in place and investors continue to invest on the basis of low labour costs and, to an extent, ethical production, there is no certainty that these alone will ensure a return to previous growth levels.

The fact that the gains made in advancing working conditions, despite some setbacks during the economic crisis, have withstood any major pressure to backtrack is a testament to how thorough an understanding there is in the industry about the basic features of the labour law and international labour standards. The continued policy of requiring all export factories to be part of the labour-monitoring Better Factories Cambodia and the recent extension of the programme, mandated by the Government and GMAC up to the end of 2013, equally demonstrates how much the monitoring of working conditions has become part of sector self-preservation.

Given that much of Cambodia's success in this field has been built on the foundations of basic labour standards, there is a necessity to move beyond mere compliance with labour laws to address more systematic issues concerning workers' entitlement and welfare. Short-term contracting, for example, impacts on workers' rights vis-à-vis their freedom of association and the right to organize, both of which are protected in ILO Conventions ratified by Cambodia.<sup>164</sup> Continued attention is also needed to address occupational safety and health issues by establishing appropriate management systems and by advancing better labour management practices, including mechanisms

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<sup>164</sup> Short-term contracting has been identified by the International Trade Union Congress and the ILO as a major obstacle to the achievement of decent work. The ILO has been working to address this issue because it undermines the very basis of a range of international labour standards and workers' rights (WSM, 2009). The industrial relations MOU of September 2010 calls for a joint study by workers and employers to analyse the impact of short-term contracting on the garment sector.

for worker and employer dialogue and grievance processes.

An important constraint with the current model of labour monitoring is its focus on major exporting garment factories only. For the improvements in working conditions to be universally adopted, there is a necessity to bring subcontracting factories towards the same standards as applied to core exporting factories. The recent establishment of a subdecree intended to further regularize subcontracting factories and ultimately bring them under the labour monitoring of Better Factories Cambodia is a move in this direction.

To what extent buyers will remain keen to promote labour standards, even if it means a higher cost in the short run, is a larger issue. There is necessity to increase labour productivity and to secure a better operating environment for both workers and employers through quality collective bargaining agreements at the enterprise and sector levels.

The growth and development of Cambodia in the past decade has been closely linked to the growth and development of the garment sector and to the labour of thousands of low-skilled young women migrating from provinces to work in the factories. The garment sector has proved a mixed blessing: It has certainly had a gender dividend in that it has promoted women's employment in formal workplaces and raised the female labour force participation and employment rate. But it has also made women more vulnerable to external forces that can put the brakes on many of the hard-won gains. At the same time, such a low skill-oriented, export-reliant sector cannot be sustainable in the long term and, should Cambodia move up the ladder of the value chain in the global garment industry, the issue of skills development of these women workers is of critical importance.

Women should in the future also find career paths towards higher-end jobs in the industry. There will be increasing moves by factories to invest in and support technical skills training for replacement of foreign workers, and this will provide Cambodian women with pathways to higher-level positions that will allow them to address the inherent gender imbalances in the industry. At the same time, existing concerns on working conditions in the sector need to be addressed to improve the working lives of its thousands of women workers.

The hundreds of thousands of women who have worked in the garment sector in the

past ten years are also an untapped source for small-scale entrepreneurial activities. There is a continued need to look at the potential of the garment workers to participate in savings schemes and in small-scale business development programmes as a way to secure workers' post-garment sector livelihoods and to support local economic development.

The East Asian Tigers provide examples of how garment manufacturing may be used as a stepping stone to greater industrial development. After first entering the garment trade in the 1960s and 1970s, these countries moved in relatively short time to managing a larger portion of their supply chain beyond simple assembly – movement towards full-package supply.<sup>165</sup> Then, as industrial upgrading continued, skills and wages increased, and these countries began to outsource basic assembly functions to cheaper Asian economies, including China, Indonesia, Thailand and, later, Cambodia. Today, it is enterprises from these pioneer countries that retain the ownership of much of the industry in Cambodia. They form part of a triangle model of garment production whereby Western retailers place orders with manufacturers based in industrialized Asia, who in turn coordinate production and export of the clothes in the region's lower-wage economies.<sup>166</sup>

Cambodia faces a range of structural problems that may hinder its ability to follow in these countries' footsteps; among them are its foreign ownership and lack of domestic economy stronghold, which some analysts argue constitute a weak foundation for industrial upgrading. This may be true, but there are reasons to suggest that changes can still be made, even if the fundamental structure of the sector remains the same in the short run.

The narrow market focus is also an issue that needs to be addressed. Currently, Cambodia's garment sector is almost fully dependent on the US and EU markets. Although the current post-economic crisis indicators are promising and the sector is looking towards a strong rebound in 2011, there is a need for enterprises to diversify both their export markets and product mix. Long term, this will be crucial for ensuring the sector's continued growth and resilience to external shocks.

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<sup>165</sup> Gefeffi, 1999.

<sup>166</sup> *ibid*, 1999; Heintz, 2007.

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