

KINGDOM OF CAMBODIA



MINISTRY OF COMMERCE



## **CAMBODIA'S GARMENT INDUSTRY: MEETING THE CHALLENGES OF THE POST-QUOTA ENVIRONMENT**



October 2004

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**PHASE 1 REPORT**

**CAMBODIA'S GARMENT INDUSTRY:  
MEETING THE CHALLENGES OF THE POST-QUOTA  
ENVIRONMENT**

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**TA Report for the Asian Development Bank  
TA No. 4131-CAM: Preventing Poverty and Empowering Female Garment Workers  
Affected by the Changing International Trade**

October 2004

## Foreword

I am pleased to be given this opportunity to write the foreword to this impressive research report on the Cambodian garment industry. In particular, we place great value on the contribution that the Asian Development Bank (ADB) is making to the debate on the further development of the industry, by their generous sponsorship of this research project and all the workshops and stakeholder meetings that have been held over the past year.



The ready-made garment markets and industry around the world are preparing for the most significant changes in their recent history when the quotas are lifted at the end of this year. New business strategies are being adopted all over the globe. Investments are being made to enhance capacities in preparation for the change. Marketing activities are becoming much more pro-active than they were previously.

In Cambodia, our industry has made remarkable progress during recent years to achieve garment exports of US\$ 1.6 billion in 2003. The Government recognizes the work that the industry has done to earn the excellent reputation amongst the major buyers for “compliance” that has become a unique selling feature for the Cambodian industry.

However, as this valuable report points out, there are significant issues that both the industry and the Government need to address, so that we can supply garments to the market as quickly as our competitors and at competitive costs. We need to significantly adapt our Cambodian circumstances to meet buyers’ requirements – to reduce lead times, to improve productivity, to build quality, and strengthen value-added.

The report lays out an ambitious reform agenda for both the public and private sectors, and also points the way towards a Strategic Action Plan for Cambodia’s garment industry. This calls for a wide range of measures to reduce import-export procedures and associated costs, to eliminate unofficial payments, to address production costs, such as the cost of electricity, which are out of line with international norms, to strengthen the quality of the workforce, and to promote the development of backward linkages and the involvement of Cambodian investors in the garment industry.

We know that we must address these issues in order to ensure that we can have further export led growth, and I am personally committed to working in these directions. The garment industry has served the country well these last few years. I am sure that by working together we can have more success in the future by addressing all of the points of common concern.

A handwritten signature in black ink, consisting of a large, stylized initial 'C' followed by a long, sweeping horizontal line that ends in a small upward hook.

H.E. Cham Prasidh  
Senior Minister  
Minister of Commerce

## Acknowledgements

The study was carried out in partnership with the Cambodian Ministry of Commerce, with the ministry as the executing agency. The TA project team would like to thank the following ministries and organizations for their assistance in the preparation of the report.

- Cambodian Ministry of Commerce;
- Cambodian Ministry of Women's and Veteran's Affairs;
- Cambodian Ministry of Labor and Vocational Training;
- Cambodian Ministry of Industry, Mines and Energy;
- Cambodian Ministry of Economy and Finance;
- Council for the Development of Cambodia;
- Cambodian Investment Board;
- Garment Manufacturers' Association of Cambodia; and
- Chamber of Commerce of Cambodia;

Without the benefit of their information, experience and opinions, the comprehensive nature of the study would not have been possible. The TA project team is particularly grateful for the most generous support provided throughout by many Asian Development Bank (ADB) staff, both at ADB headquarters and in the ADB Cambodia Resident Mission. In addition, the Garment Manufacturers' Association of Cambodia (GMAC) and its members gave generously of their time and insights.

The TA project team would also like to acknowledge the inputs received from many donor organizations, including the World Bank, International Finance Corporation (IFC), International Monetary Fund, International Labor Organization (ILO), UNCTAD, and several bilateral donors and embassies. The team would also like to thank the many members of the garment industry and related enterprises that were interviewed, as well as the major non-government organizations (NGOs) and business associations. The TA project team greatly appreciates the contribution of the legal professionals and consultants that provided time, information and recommendations to this study. Since the garment sector involves such a wide range of topics and issues, it has been vital to have the support of these organizations and individuals.

The TA project team would also like to thank the Royal Cambodian Government, donor, NGO, trade union, and private sector participants in the National Workshop on 'The Garment Industry In Cambodia: The Engine for Further Sustained Growth of the National Economy' held at the Hotel Inter-Continental, Phnom Penh on 12 February 2004. The feedback provided during this workshop was useful to the TA project team in making revisions to the private sector assessment and in providing a greater understanding of the major issues.

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The findings, interpretations and conclusions expressed in this report do not necessarily reflect the policies or views of the Cambodian Ministry of Commerce or the Asian Development Bank and are solely the responsibility of the authors.

**Executive Summary**  
**Phase 1 Report**  
**Cambodia's Garment Industry**  
**Meeting the Challenges of the Post-Quota Environment**

October 2004

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**1. Introduction**

This report constitutes the major output of Phase 1 of the ADB-financed technical assistance (TA) project<sup>1</sup> to identify ways and means of preventing poverty and empowering female garment industry workers affected by the changing international garment trade. The report findings are based on extensive interviews and interactions with all key stakeholders during October 2003 to June 2004, a systematic company-level survey of 21 garment manufacturers in Cambodia, a Socio-Economic Survey of Garment Employees in Cambodia (SESGEC) carried out during late 2003 to early 2004, a macroeconomic modeling exercise, and desk research of existing studies, databases, and other information resources.

**2. Cambodian Context**

Two major elements of the Cambodian economy and society deserve consideration as the context within which the garment industry has developed. First, the important role of the garment industry in addressing issues relating to poverty and female worker empowerment in Cambodia. While Cambodia still reports the lowest Gender Development Index in Asia, there is no doubt that employment opportunities in the garment industry have played a significant role in alleviating poverty and in raising the profile of women workers. Any changes in the industry – either positive or negative – will have strong effects on the progress made so far in these two areas.

Second, the overall investment climate in which the garment industry is operating. A recent World Bank study (World Bank 2004) reported that the top priorities of the business community in Cambodia are governance, the rule of law, and corruption. The serious constraints posed by these factors in Cambodia, as well as the dilapidated infrastructure, are likely to become even more acute as Cambodian-based garment businesses face an increasingly competitive global marketplace in the post-quota period.

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<sup>1</sup> TA No. 4131 CAM/Preventing Poverty and Empowering Female Garment Workers Affected by the Changing International Trade.

### **3. Global Context**

The key date for the garment industry worldwide is 1 January 2005, when quotas will be finally phased out.

The ending of the quota system is likely to intensify the following major industry trends:

- Cost competitiveness will continue to be a key factor as garments prices are expected to continue to fall after 2004.
- Buyers are requiring faster deliveries to meet increasing levels of consumer demand and ever decreasing product cycle times. This will place greater and greater emphasis on countries with more complete supply chains that are able to meet these increasing demands. It is noticeable that many garment supply countries have been making strategic investments in recent years to ensure that their supply chains are 'complete'.
- Buyers want business to be as straightforward and uncomplicated as possible. They will have a greater choice after the ending of quotas, and they will buy from preferred suppliers who offer consistent quality, reliable delivery dates, competitive prices and productivity levels at international standards. The number of countries in the garment industry can be expected to fall, and buyers will have greater value-added service requirements.
- Foreign investors will have more freedom in where to place offshore investments after the ending of the quota system and will prefer host countries that enable successful operations with the least problems.
- In general, the global garment market has been demanding higher levels of (a) personal service, (b) quality consistency, (c) delivery lead times, (d) product innovation, (e) price competitiveness, (f) reliability, and (g) country image (including compliance with corporate codes of conduct).

The overall impact of the new global market environment on Cambodia's garment exporters, and in particular the increasing competitiveness in the global textile and clothing (T&C) industry, is expected to be a reduction in exports, re-trenched workers without alternative job opportunities, and a downturn in the national economy. Urgent action is needed now to prevent this from happening.

### **4. Key Characteristics**

The Cambodian garment industry is in a unique position.

It has grown very quickly (presently involving around 196 companies with around 230,000 employees of whom 85-90% are women) but has been almost exclusively driven by foreign investment and by comparative advantages resulting primarily from preferential access to the major markets and, to a lesser extent, by cheap labor. In recent years, the industry has been considered one of the most compliant in terms of labor practices and Cambodia has been awarded incremental increases in quota allocations by the US government (an additional 14% in 2004 of a possible increase of 18%).

The industry remains virtually 100% foreign owned, with most of the decision takers largely based in East Asia from where production orders are received together with fabric and accessory supplies and delivery instructions. These foreign owners make decisions about operations in Cambodia based on global business developments and most have similar operations in other countries, such as China.

The industry is almost 100% dependent on imported yarns (for knitwear), finished woven and circular knitted fabrics (for woven and knitted cut and sew garments), all accessories, and almost all packaging and presentation materials. The domestic material content is limited to some cardboard cartons and poly bags. The domestic value added content of the Cambodian garment industry amounts to 28.6% of garment exports.

Cambodia's garment industry has recorded impressive export performance, with overall garment exports rising from just over US\$26 million in 1995 to just over US\$1.6 billion in 2003. This amounted to almost 80% of total Cambodian exports, and Cambodia's garment exports represented 0.74% of total global garment exports by value. In 2003, exports to the US broke through the billion-dollar barrier for the first time at US\$1.1 billion, and exports to the EU surpassed US\$407 million in 2003; the two markets accounting for over 95% of total exports. The wages earned by garment industry employees and related remittances have had a significant impact in raising the living standards of Cambodian women and the poor rural households that they support.

Reflecting general business operating conditions in Cambodia, the garment industry faces a number of operating and structural problems. These include the complexity of import-export procedures, corruption and bribery that accounts for up to 7% of total sales value, worker motivation and productivity, and high costs of infrastructure – especially the cost of power. The key structural problem concerns the issue of lead times, a factor that is becoming increasingly important in the global garment market. This relates closely to the almost complete absence of backward linkages in the Cambodian garment industry.

## 5. The Macroeconomic Impact

In order to examine the macroeconomic impact of projected developments in both the Cambodian and global garment industry, the Phase 1 report utilized a simple macroeconomic model of the Cambodian economy and developed two scenarios. These were (a) a baseline scenario that assumes the absence of any systematic policy to improve the Cambodian garment industry resulting a decline in exports from US\$1.6 billion in 2003 to US\$1.3 billion in 2010, and (b) a growth scenario that assumes that improvements are made in the Cambodian garment industry which will enable exports to grow by 5% per year and contribute further to reducing poverty.

The table below shows the impact of these two scenarios on the garment industry, as well as key macroeconomic indicators. In the garment industry, the baseline scenario will result in the loss of 32,000 jobs, and the opportunity cost of not making reforms to facilitate the growth scenario is almost 100,000 jobs. At the macroeconomic level, a full 1.5% of real GDP growth would be lost annually if the baseline scenario prevails.

Macroeconomic Impact: Analysis of Scenarios								
	Scenario	Actual			Changes		Growth-Baseline	
		2003	2007	2010	(2)-(1)	(3)-(1)	2007	2010
		(1)	(2)	(3)				
<b>Garment Industry Variables</b>								
Exports (mn US\$)	Baseline	1,608	1,497	1,312	(110)	(296)	618	1,287
	Growth	1,608	2,115	2,599	508	991		
Employment ('000)	Baseline	230	219	198	(11)	(32)	45	96
	Growth	230	265	294	35	64		
<b>Macroeconomic Variables</b>								
Nominal GDP (mn US\$)	Baseline	4,000	4,680	5,350	680	1,350	340	1,000
	Growth	4,000	5,020	6,350	1,020	2,350		
Real GDP Growth (%)	Baseline	5.0%	4.0%	3.5%	-1.0%	-1.5%	1.0%	1.5%
	Growth	5.0%	5.0%	5.0%	0.0%	0.0%		
Government Income (mn US\$)	Baseline	430	540	610	110	180	50	174
	Growth	430	590	784	160	354		

Source: Estimates from macroeconomic model (Chapter 6)

## 6. Conclusions and Core Vision

The Cambodian garment industry has achieved great success over a short period of time. The garment industry has become the engine driving the national economy (accounting for around 12% of GDP), is making the greatest national contribution to poverty reduction by creating some 230,000 direct jobs (65% of manufacturing employment), and generates the largest share of the country's foreign currency earnings (80% of total exports in 2003).

However, the global market environment is in a transitional stage and will change at the end of 2004 with the ending of quotas. These changes will create new challenges for the Cambodian garment industry. The quota premium cost advantage will disappear and, although Cambodia will continue to enjoy some preferential market access, suppliers offering lower costs through higher productivity levels and shorter lead times will gain the advantage.

The following analysis of strengths, weaknesses, opportunities and threats (SWOT) concisely sums up the conclusions of the Phase 1 report and reflects the unique position faced by the Cambodian garment industry.

### SWOT Analysis of the Cambodian Garment Industry

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Some acquired know-how and experience in the industry, including within the semi-skilled labor force</li> <li>• Strong offshore investors with technical and commercial know-how and capital resources</li> <li>• Current preferential regimes in terms of quota and duty-free access – to the US, EU, Canada, Australia, New Zealand and Norway</li> <li>• Large pool of unskilled cost-effective labor available from the rural areas to support expansion of the industry if required</li> <li>• Large levels of exports and experience in the export markets</li> <li>• Positive market image, especially in the area of labor utilization and compliance</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Industry heavily focused on cut, make and trim (CMT) garment manufacture, with all major decisions across the board taken off-shore</li> <li>• Lack of inter-industry linkages and few serious subcontractors, and policy impediments to backward linkage development</li> <li>• No Cambodian lead investors in the industry</li> <li>• Low level of human resource development and low skill base resulting in low productivity and higher than necessary costs</li> <li>• Shortage of skilled middle-management/shop floor supervision/skilled workers</li> <li>• Heavy use of expatriate supervisors leading to culture and communication gaps</li> <li>• Seriously low levels of local value added, and low levels of technology as well</li> <li>• Longer lead times than competitors</li> <li>• High levels of official and unofficial transactions costs, especially in the import/export processes</li> <li>• High costs of power and other utilities</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Potential to enhance the productivity of the labor force through training and better human resource practices</li> <li>• Potential in the EU market as former Eastern European members of the EU become less competitive</li> <li>• Potential in the US market, especially if preferential access to this market can be enhanced</li> <li>• The establishment of an Export Processing Zone</li> <li>• Investment in backward linkages</li> <li>• Regional integration with ASEAN countries and ASEAN cumulation</li> <li>• Benefits of WTO membership</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Performance of competitor countries, such as China, Bangladesh, Vietnam, etc.</li> <li>• Unwillingness of local investors to enter the garment sector</li> <li>• Phasing out of preferential market access agreements</li> <li>• Possible instability resulting from labor disputes and the high costs resulting from certain provisions in the labor law</li> </ul>

Source: Field Work interviews, desk research

The following vision statement is proposed:

**The Core Vision:** Create an environment in which the Cambodian garment industry can develop export competitiveness in niche markets and empower garment industry employees by fairly distributing the benefits

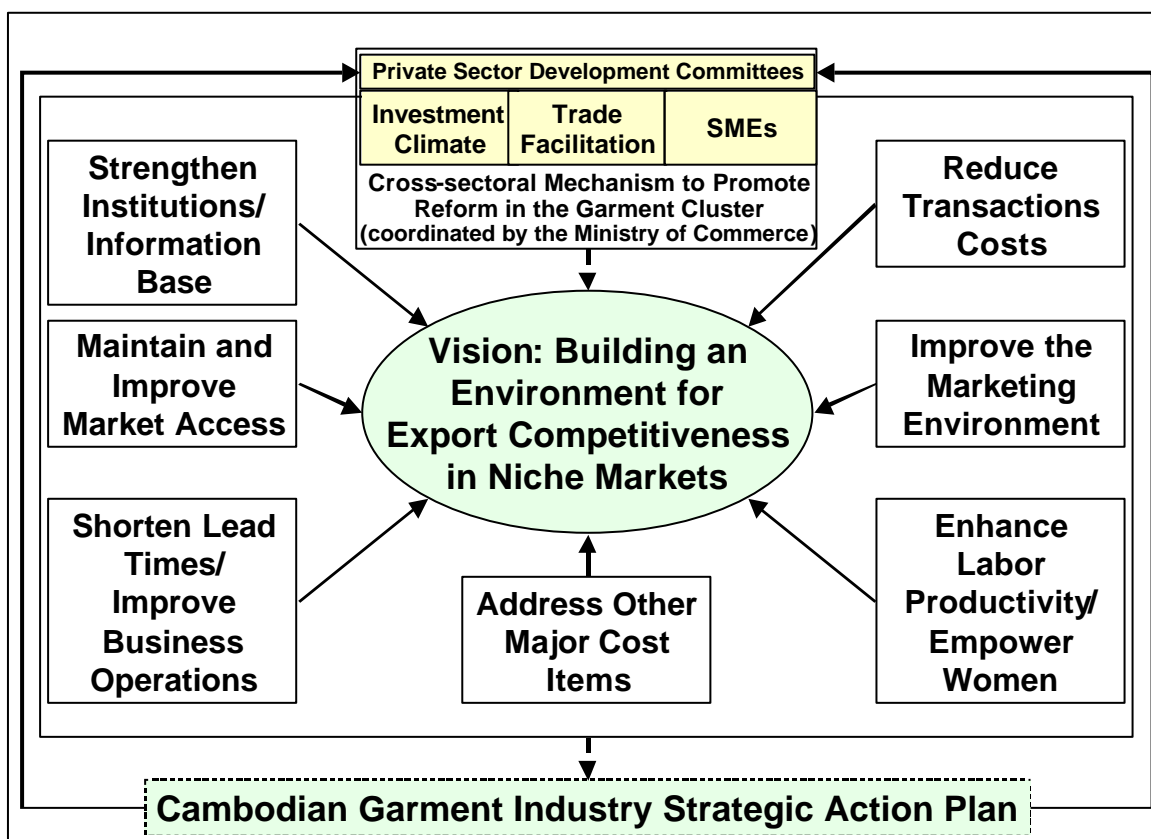
The key objective of the vision and all the measures proposed to achieve it will be to continue to increase exports and generate new jobs. The export target for 2010 is set at US\$2.6 billion and will involve movement away from the low value-added woven garment sector towards higher value-added knit, cut and sew garments and knitwear garments. Employment in the industry will then approach 300,000 jobs.

## 7. Building a Cambodian Garment Industry Development Strategy

A new and coordinated development strategy is required for the various players in the Cambodian garment industry cluster as the end of the quota system approaches and the industry is on the verge of either developing further or declining. The development strategy should focus on addressing the competitiveness of the industry, on developing policies to address key weaknesses and harness key opportunities, and on recognizing critical interconnections between all the policy measures.

The following graphic summarizes the basic elements of the Cambodian Garment Industry Development Strategy and the recommended institutional framework to implement this.

**The Cambodian Garment Industry Development Strategy**



The policy recommendations are summarized in the table below:

<b>Elements of the Cambodian Garment Industry Development Strategy</b>	
<b>Action</b>	<b>Measure</b>
1. Strengthen Institutions and Build an Information Base	<ul style="list-style-type: none"> <li>• Establish a high-level comprehensive policy reform and donor coordination mechanism</li> <li>• Strengthen GMAC</li> <li>• Strengthen training institutions</li> <li>• Strengthen employee organizations</li> <li>• Develop an information and analytical base on the Cambodian garment industry</li> <li>• Develop an information base on international market data</li> <li>• Developing and supporting a sustainability strategy for the ILO Garment Sector project</li> </ul>
2. Maintain and Improve Market Access	<ul style="list-style-type: none"> <li>• Support efforts to enhance market access to the US market</li> <li>• Support efforts to reform the EU market access scheme</li> </ul>
3. Reduce Transactions Costs	<ul style="list-style-type: none"> <li>• Explore short-term measures to remove unofficial payments</li> <li>• Provide full support in the medium-long term to the ambitious reforms supported by the World Bank and other donors</li> </ul>
4. Shorten Lead Times and Improve Business Operations	<ul style="list-style-type: none"> <li>• Carry out an investment promotion drive, including approaches to potential Cambodia investors</li> <li>• Promote investments in backward linkage development, possibly through forming a “Garment Industry Investment Fund”</li> <li>• Integrate SMEs into the garment industry cluster through reforms in tax policies, investment rules, and removal of other SME impediments</li> <li>• Strengthen supply chains through closer regional integration</li> <li>• Accelerating the development of export processing zones</li> </ul>
5. Improve the Marketing Environment	<ul style="list-style-type: none"> <li>• Implement a marketing plan to promote the Cambodian garment label</li> <li>• Carry out an ongoing and sustained export promotion campaign</li> </ul>
6. Enhance Labor Productivity and Empower Women	<ul style="list-style-type: none"> <li>• Provide financial support to train garment industry employees</li> <li>• Address the various issues related to the Labor Law</li> <li>• Develop programs to assist displaced garment industry workers and job seekers to find employment in other sectors</li> <li>• Intensify efforts to introduce improved practices with regard to human resource practices and working conditions</li> <li>• Develop a comprehensive human resource development plan for the garment industry</li> <li>• Consider the establishment of a Cambodian garment design institute</li> <li>• Create opportunities for the development of female entrepreneurs</li> </ul>
7. Address Other Major Cost Items	<ul style="list-style-type: none"> <li>• Address the extremely high cost of electricity</li> <li>• Reduce unofficial costs in transporting a container through Sihanoukville Port</li> </ul>

The first step towards implementation of the Cambodian Garment Industry Development Strategy will involve the preparation of a Cambodian Garment Industry Strategic Action Plan based on the reform agenda outlined above. Drawing on the analysis in the Phase 1 report, a working draft of the strategic action plan with details on the suggested measures will be formulated by the TA project team following the indicative structure presented below. However it is critical that the final version of the strategic action plan is developed and owned by the Cambodian garment industry public and private sector stakeholders.

<b>Indicative Structure for the Cambodian Garment Industry Strategic Action Plan</b>				
Action /Measure	Implementing Agency	Resources Required	Implementation Time Frame	Remarks/ Action

In the second step it is recommended that the high-level, cross-sector comprehensive policy reform and donor coordination mechanism be coordinated by the Cambodian Ministry of Commerce and explicitly utilize and involve the three Sub-Steering Committees under the newly-formed Private Sector Development Policy and Strategy Mechanism (dated 26 July 2004). The Sub-Steering Committees cover the areas of (a) Investment Promotion and PPI, (b) Trade Facilitation, and (c) SMEs. It is proposed that each of the policy recommendations be allocated, where possible, to representatives on one of Sub-Steering Committees to take primary responsibility for the development of more detailed action plans and subsequent implementation. This will permit the cross-sectoral recommendations related specifically to the garment industry to be implemented quickly and efficiently. Recommendations that do not fall naturally under any of the three Sub-Steering Committees could be allocated for action to the relevant government ministry or agency. In all activities, the involvement of the private sector in general and GMAC in particular should be given high priority. As explicitly stated by the Prime Minister (Hun Sen, 2004), this involvement of the private sector could be accomplished through links to the Government-Private Sector Forum and Working Group Seven on Trade Facilitation and Processing for Export (see Annex 4).

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## Acronyms

AC	Arbitration Council
ACP	African, Caribbean and Pacific countries
ADB	Asian Development Bank
AFTEX	ASEAN Federation of Textile Industries
AGOA	African Growth Opportunities Act
ASEAN	Association of Southeast Asian Nations
ATC	WTO Agreement on Textiles and Clothing
AUSAID	Australian Agency for International Development
bn	billion
BMRE	Balancing, Modernization, Re-structuring and Expanding
BW	Bonded Warehouse
CamControl	Cambodia Import Export Inspection and Fraud Repression Department
CBW	Common Bonded Warehouse
CDC	Council for the Development of Cambodia
CDRI	Cambodia Development Resource Institute
CED	Customs and Excise Department
CGTC	Cambodia Garment Training Center
CIB	Cambodian Investment Board
CIDA	Canadian International Development Agency
CLMV	Cambodia, Lao PDR, Myanmar, Viet Nam
CM	cut and make
CMT	cut, make and trim
CRD	Cambodian Researchers for Development
CUTS	Consumer Unity and Trust Society
DANIDA	Danish International Development Agency
EBA	Everything But Arms
EDP	Entrepreneur Development Program
EEOW	Economic Empowerment of Women
EIC	Economic Institute of Cambodia
EPZ	Export Processing Zone
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FTA	Free Trade Agreement
GDI	Gender Development Index
GEM	Gender Empowerment Measure
GMAC	Garment Manufacturers' Association of Cambodia
GPSF	Government-Private Sector Forum
GSD	Gender and Social Development
GSP	Generalized System of Preferences
HDI	Human Development Index
HPI	Human Poverty Index
HR	Human Resource
ICT	Information and Communications Technology
IFC	International Finance Corporation
ILO	International Labor Organization
IMF	International Monetary Fund
ITC	International Trade Center
ITMF	International Textile Manufacturers Federation
JODC	Japanese Overseas Development Corporation
LDC	Least Developed Countries
LFS	Labor Force Survey
MFA	Multi Fiber Arrangement
MFN	Most Favored Nation
MMF	Man-Made Fiber

MNC	Multi-National Corporation
MOC	Cambodian Ministry of Commerce
MOLVT	Cambodian Ministry of Labor and Vocational Training
MOSA	Cambodian Ministry of Social Affairs
MOWVA	Cambodian Ministry of Women's and Veteran's Affairs
MPDF	Mekong Project Development Facility
MSM	Maastricht School of Management
mn	million
NAFTA	North American Free Trade Area
NGO	Non-Government Organization
NIFT	National Institutes of Fashion Technology
ODM	Original Design Manufacturer
OPT	Outward Processing Trade
OSH	Occupational Safety and Health
PADEK	Partnership for Development in Kampuchea
PICS	Productivity and Investment Climate Survey
PPA	Participatory Poverty Assessment
PPI	Private Participation in Infrastructure
PSF	Private Sector Forum
RGC	Royal Government of Cambodia
RMG	Ready Made Garment
RTP	Regional Trade Pact
SAARC	South Asian Association for Regional Cooperation
SESGEC	Socio-Economic Survey of Garment Employees in Cambodia
SEWA	Self Employed Women's Association
SHG	Self Help Groups
TA	Technical Assistance
T&C	Textiles and Clothing
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
UNIDO	United Nations Industrial Development Organization
USAID	US Agency for International Development
VAT	Value-Added Tax
VTS	Vocational Training Schools
WTO	World Trade Organization

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## Part 1: Introduction and Context

### 1. Introduction

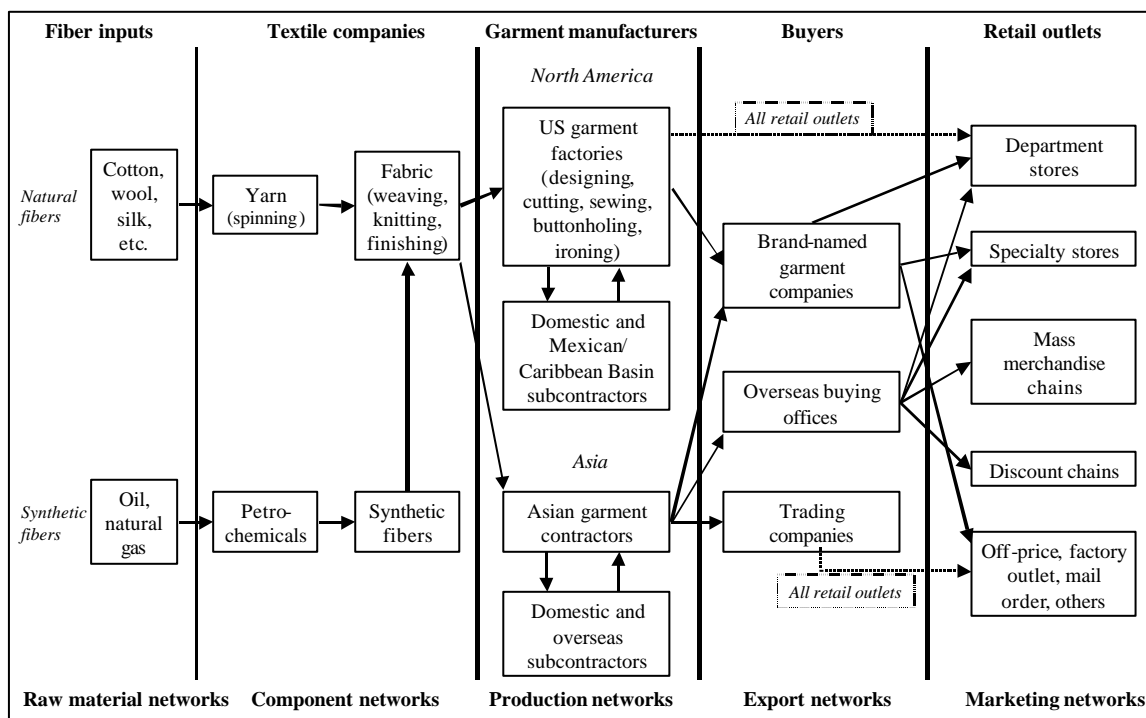
This chapter provides a brief overview of the value chain approach and cluster framework and presents the basis and structure of the report.

#### 1.1. The Conceptual Framework – Looking at the Cambodian Garment Value Chain and Cluster

The conceptual framework for the present study draws together two complementary approaches – the value chain, which captures the flow of activities (design, proto-typing, production, marketing, and distribution) from the basic raw materials to the final consumer, and the cluster approach, which places the value chain in a national and regional context and considers how all the key stakeholders interact.

The value chain can be defined as “a network of connected and interdependent organizations mutually and co-operatively working together to control, manage and improve the flow of materials and information from suppliers to end-users.”<sup>1</sup> Value chain management, in turn, is “the rationalization and control of all activities in the Value Chain, encompassing sourcing, manufacturing, distribution, and marketing and most recently sourcing and shopping”.

**Figure 1: The Global Garment Industry Value Chain**



Source: Applebaum and Gereffi, 1994, as adapted by Gereffi and Memedovic, 2003.

Figure 1 presents a structure of the global garment industry value chain – proceeding from the raw material networks through component networks, production networks, export networks and marketing networks. Two general models are presented – the Asian model and

<sup>1</sup> Paraphrasing a presentation of supply chain expert J. Aitken.

the North American model<sup>2</sup>. The value chain essentially takes a business sector perspective and, when applied, can provide a useful bridge between the business sector and the public sector in terms of identifying the areas of reform necessary to strengthen the supply chain. In the Cambodian context, a comprehensive analysis of various supply chains has recently been completed by the World Bank (see World Bank 2003).

The concept of value chain management as a means of improving company performance has dominated western business thinking for more than three decades and during that time it has evolved through at least three distinct stages. In the first stage, value chain management focused primarily on integrating productive processes within single companies and removing the internal obstacles and functional organizational rigidities that prevented companies from operating more efficiently and from responding more quickly to new opportunities. Dramatic cost savings can be achieved in this first phase, demonstrating clearly that enhancing the Value Chain is a major factor – if not the most critical factor – in achieving cost competitiveness.

In the second phase, efforts were made to create seamless linkages between and among companies. In this phase decisions concerning i) what was produced, ii) what processes were used in production/ distribution, iii) when products were produced and when they were shipped, iv) how much product was produced at any given time, and v) what prices were paid for these products and what levels of credit extended within the chain, were internalized within the chain itself. Systems were created to monitor and track the performance of individual company participants and specific processes within the chain, and to create transparency throughout the chain. The competitiveness gains realized in this second phase of value chain management development were again quite extensive. Companies linked together as value chains began to compete not as stand-alone entities but as integrated chains in direct competition with other chains.

In a subsequent, third phase, value chain management has increasingly focused on engaging the final customer - drawing the customer (either consumers or industrial customers) directly into the value creation process. This third phase is highly dependent on information and communications technology (ICT) and in particular on developments taking place in the Internet. Factors that have emerged within the global business environment have driven value chain development. In particular, time based competition in the form of reduced product life cycles, mass customization, higher customer expectations, continuously renewed and improved production technology, and correspondingly shorter process life cycles call for ever greater competitive proficiency. In the 21st century competition comes from all points of the globe and from unexpected directions - from new start up enterprises that are heavily capitalized, from new technologies that shift the rules of competition, and from the strategic migration of traditional industries.

The kind of flexibility offered by strategies based around value chain management are critical to survival and growth in the 21st century – and these factors are all driving competition in the global garment industry. The global garment industry has progressively been moving through these three phases and in this process, national players around the world have been increasingly integrated into the global garment industry value chain. A recent UNIDO report (Gereffi and Memedovic, 2003) discusses the potential for upgrading the garment industry value chain in developing countries and outlines ways in which the various participants in the global garment value chain must adapt to survive in the post-quota environment.

With regard to clusters, this report examines the way in which the range of activities that comprise the garment value chain in Cambodia are influenced by other institutions involved in various ways with the industry participants. This includes institutions from relevant

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<sup>2</sup> A European version would have the manufacturing in Eastern Europe, North Africa, and Asia.

government agencies to educational institutions, suppliers of services, trade unions, industry associations, etc. A quote from Michael Porter underlines the importance of the cluster approach, “Clusters affect competitiveness within countries as well as across national borders. Therefore they lead to new agendas for all business executives – not just those who compete globally. More broadly, clusters represent a new way of thinking about location, challenging much of the conventional wisdom about how companies should be configured, how institutions such as universities can contribute to competitive success, and how governments can promote economic development and prosperity.”

In particular, stronger clusters provide the opportunity to move to a new level of private-public partnership – something that will be critical in the Cambodian context to address the range of constraints affecting the investment climate.

Porter, 2003, in a competitiveness study of Thailand, offers some guidance on the question of cluster development in developing economies. This provides some useful research directions for the Cambodian garment cluster study:

- Improving the general business environment is essential, but more focused cluster development is needed to rise to significantly higher income levels;
- Developing economies should upgrade traditional clusters, including agriculture, not abandon them;
- Recruitment of foreign direct investment should focus on existing and emerging clusters, not generalized appeals, and investment incentives should be weighted toward training, infrastructure, and other areas that upgrade the cluster versus general subsidies and tax holidays
- Existing multinational corporations (MNCs) can perform a valuable function as the basis for enhanced cluster development, and the best way to retain companies is to make them part of a cluster to support higher local productivity
- Free trade zones should be organized around clusters, and regulations designed to encourage linkages with the local economy;
- A formal structure for cluster development is an important component of economic development, and this should be managed by the private sector, with the government participating and providing seed funding for cluster assessment and the formation of cluster-based industry.

## **1.2. Report Basis and Structure**

This Phase 1 report of the ADB-financed technical assistance (TA) project<sup>3</sup> is designed to identify ways and means of preventing poverty and empowering female garment workers affected by the changing international trade.

The Phase 1 report is based on the following information and related resources:

- Extensive interviews and interactions with all major stakeholders over the period October 2003-June 2004, with the exception of offshore owners<sup>4</sup>;
- A systematic company-level survey of 21 garment manufacturers in Cambodia (see Annex 2);
- A Socio-Economic Survey of Garment Employees in Cambodia (SESGEC) carried out as a part of the TA project Phase 1 activities from late 2003 to early 2004;
- The underlying information base and structure of the macroeconomic model used to simulate the impact of changes in the garment industry on the Cambodian economy; and

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<sup>3</sup> TA No. 4131 CAM/Preventing Poverty and Empowering Female Garment Workers Affected by the Changing International Trade.

<sup>4</sup> Including a major National Workshop of all stakeholders (see Annex 1).

- Extensive desk research of existing studies, databases, and other information resources, including the experience of the consultants in many other countries.

Following this brief presentation of the value chain and cluster approaches to economic development, Chapter 2 examines the situation facing the Cambodian garment industry. The report provides the domestic rationale for the project in terms of the Cambodian situation regarding poverty and the empowerment of women. The report then proceeds to examine the domestic and international contexts within which the Cambodian garment industry finds itself – looking first at the domestic investment climate and then at the international trends in the global garment industry, the ending of quotas, and developments in preferential trade access systems.

Chapter 3 profiles the Cambodian garment industry with sections on overall contributions of the garment industry to the economy structure of the Cambodian garment industry and value chains of specific parts of the garment industry, operational constraints experienced by garment companies, a wide ranging benchmarking of the Cambodian garment industry against major competitors; specific challenges and issues faced by the Cambodian garment industry; and finally an examination of market access and regional dimensions of the sector.

Chapter 4 examines in some detail the situation of garment industry employees – the backbone of the industry. It reports on the extensive socio-economic survey carried out for this TA project and related research and activities dealing with employment issues.

Chapter 5 considers the major players in the Cambodian garment industry cluster and identifies constraints, critical issues, and challenges facing the participants. The chapter concludes with a consideration of government policy towards the garment industry.

Chapter 6 presents the results of an econometric modeling exercise designed to explore the impact on the domestic economy of various scenarios in the garment industry. Two scenarios are developed – a baseline scenario and a growth scenario.

Chapter 7 draws together the main conclusions of the research exercise in an analysis of strengths, weaknesses, opportunities and threats and derives from this a core vision for the future development of the industry and related export targets.

Chapter 8 develops elements of a Cambodian garment industry development strategy and proposes an approach to fully developing the subsequent action plan and implementing the various components of the action plan.

## **2. Setting the Scene**

This chapter presents the present situation of the Cambodian garment industry – moving from sections on the issue of poverty and investment climate in Cambodia to sections highlighting key trends and developments in the global garment industry.

### **2.1. Poverty Reduction and Empowerment of Female Garment Industry Workers**

Poverty alleviation is an overarching objective of the partnership between the Royal Government of Cambodia and the Asian Development Bank (ADB). Within this context, a key objective of this report (and the TA project) is to contribute to reducing poverty and risks to the livelihoods of garment industry workers and the rural households they support. This is accomplished by examining and attempting to address intended and unintended consequences and impacts of policy interventions in the garment industry sector.

#### **2.1.1 Poverty Reduction**

The Socio-Economic Survey results of this ADB TA project, as well as research by the Oxfam (Hong Kong) supported Womyn's Empowerment Project, confirms that crises are a recurrent feature in the lives of the, largely female, garment industry workers. It is these crises - personal, social or environmental - that drive poor households, particularly in rural areas, towards further impoverishment. Lack of savings or other safety net measures push them into a vicious cycle of indebtedness and poverty.

The importance, therefore, of regular employment for garment industry workers in Cambodia cannot be overstated. Retrenchment in the garment industry will either force these workers back to rural villages with meager earning opportunities or into debt. Work security for women in the garment industry in the post quota era is therefore a prime concern and provides the most compelling argument for immediate action to ensure that the garment industry is not only sustained, but also upgraded and expanded with improved working conditions and human resource practices within the factories.

Cambodia's current population is 13.1 million people (2001 estimate) and growing rapidly at a rate of about 2.5%. Life expectancy is only 56.4 years and adult literacy rate is 67.8%. Annual per capita income is approximately US\$280. The Cambodian economy is structured around the agriculture sector (employing about 80% of the workforce and providing employment for over 70% of the poor), tourism and the production of labor intensive-manufactured products, particularly garments, for export. While 70% of the population is employed in agriculture, 12-15% does not own land.

In spite of impressive economic growth in recent years, Cambodia has one of the lowest human development performances in the region. Cambodia's Human Development Index (HDI) score (0.541) ranks 121 out of 162 internationally and is the second lowest in Southeast Asia. The Human Poverty Index (HPI) for Cambodia is 43.3%. Poverty in Cambodia is widespread with some 36% of the population living below the poverty line at US\$0.46-US\$0.63 at the 1991 exchange rate. Fighting urban poverty is also becoming a serious problem. A survey of 569 poor suburbs in the capital found that 62,249 households comprised more than one-third of the capital's population. One UN report suggests that by 2015, population in urban areas will be greater than in rural areas in many developing countries such as Cambodia. According to the poverty map of 2002, provinces with the highest incidence of poverty (39.1-53.7%), and above the national average, include Oddar Meanchey, Banteay Meanchey, Siem Riep, Kampong Chhang, Pursat, Prey Eng, Svay Rieng, and Krong Kep. Notably, these provinces are also the homes of origin of a large percentage of garment industry employees. While the garment industry sector is seen as an engine of

growth, it is recognized that in the long term, Cambodia's pro-poor strategy has to focus on agricultural and agro-industry development to have any major impact on reducing poverty.

Food insecurity and poverty are closely linked in Cambodia. Participants in the Participatory Poverty Assessment (2001), that was a part of the process of preparation for the National Poverty Reduction Strategy 2003-2005, defined poverty as being persistent hunger, a chronic condition from which the poor could not escape, except on a temporary basis. Further, since the first case in the HIV/AIDS epidemic was recorded in 1992, it is estimated that out of a population of 11 million, Cambodia has about 69,000 people living with HIV/AIDS. The estimated HIV/AIDS prevalence rate was 3.9% and 2.8% in 1997 and 2001 respectively, among adults aged 15-49 years—the most productive age group. This has exacerbated the food security of the affected individuals and households.

### **2.1.2 Status of Women in Cambodia<sup>5</sup>**

Cambodia has the lowest Gender Development Index in Asia (0.427). The Gender Empowerment Measure (GEM) of 0.283 is also among the lowest in Asia due to the low representation of women in national decision-making institutions and professional spheres. Further, Cambodian society is said to be characterized by entrenched inequality, in many essential dimensions such as income poverty (the consumption share of the poorest 10% of the population being as low as 4%, while the richest 10% have a consumption share of 20%), gender status and access to education and health. Marked regional differences within the country heighten these inequalities. An estimated 36% of the population lives below the basic needs poverty line, with rural households accounting for almost 90% of the poor. The high prevalence of HIV/AIDS, drug abuse, and the trafficking of female children, pose major threats to economic and social development. As a result of decades of civil war, isolation and low public expenditure on education (2% of GDP), health and other social sectors, quality of life in Cambodia has been negatively affected. Female literacy rate is at best only 41%. It is therefore not surprising that a majority of the young women who migrate for employment in the garment sector are illiterate. Overall the legacy of human suffering and mass destruction of the physical and social infrastructure has had a profound impact on poverty, and places a huge burden on women in particular.

The social and institutional dimension of gender-based constraints, although documented globally, is often not given adequate attention in poverty analysis and the formulation of macro economic and trade policies. The issues to be examined revolve around social norms (women viewed with reservations after working in the garment industry), as well as social and physical infrastructure available to women to allow them to meet their work commitments and demands. Their presence, role and participation in organizations such as trade unions and chambers of commerce (e.g. GMAC), and in markets for labor, goods and credit is determined by their social status. It is recognized that at the operational level, these gender inequalities and gender biases can have serious costs for the economy as a whole.

A recent MOWVA (April 2004) publication, *A Fair Share for Women*, presents a comprehensive assessment of the status of women in Cambodia based on secondary data. A collaborative publication of donors in cooperation with the MOWVA, this report was unique and reflected an effective partnership among donors in Cambodia. The overall conclusion of

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<sup>5</sup> Several international agencies including ADB, OXFAM, ILO, UNDP/UNIFEM, UNICEF and World Bank working in Cambodia, have gathered and analyzed information that helped define and analyze the overall socio economic profile of women in Cambodia. This includes various dimensions of women's overall status as well as their position in the labor market and more specifically in the garment industry. These have been used extensively and our research team would like to record their appreciation to the staff from these organizations for their time and willingness to share their experiences and reports.

the assessment is that “Gender relations in Cambodia continue to undergo uneven change: The cultural norms still firmly place women at a lower status than men. This continues despite the fact that women play an equally important and increasingly visible role as income providers for families and are a driving force for economic development”.

Following are some of the findings of the Assessment of the Status of Women in Cambodia:

- Families often fear that girls who move to urban areas will be corrupted and not be “good” for marriage (ADB 2001).
- Women and girls still work longer hours and have less leisure time than men. According to the Cambodia Demographic and Health Survey, during the rainy season women work almost 18 hours a day while men work for about 14 hours; during the dry season women and girls work about 15 hours while men and boys work 10-12 hours.
- The same survey found that many women believed that important decisions should be made by men (52%), that it is better to educate a son than a daughter (59%), and that married women should not be allowed to work outside the home (33%).
- The Human Poverty Index (HPI) is a composite measure of the percentages of people who are not expected to survive to age 40, who are illiterate, and who have no access to safe water and health services, as well as the percentage of moderately and severely underweight children under 5 years of age. As would be expected, given the high levels of mortality and child malnutrition and the poor availability of public services indicators used in the construction of the HPI, Cambodia has a high HPI in relation to other Asian countries. Only Bangladesh and Pakistan score a higher HPI than Cambodia. Analysis of the HPI also reveals that poverty is greater among Cambodian women than among men across all economic groups
- Female-headed households (34%) are among the poorest in any community. A large number of “gender studies” use women-headed households as the unit of analysis. As the level of poverty has been calculated at the household level, assessment of gender differences focused on separating data based on the sex of the household head. The 1999 Poverty Profile of Cambodia (Ministry of Planning, 1999) found that although the poverty headcount index for women-headed households (34%) was slightly lower than that of male-headed households (36%), the difference was not statistically significant. The poverty profile concluded “there is no difference in poverty rates between male and women-headed households”.
- Women are under-represented in professions and decision-making. Approximately one third of professionals are women and only 14% of legislators, senior officials and managers are women. Less than 2% of all economically active women are employed in the predominantly public sector industry groups of public administration/defense, education, and health/social work, compared to 8% men.
- Gender disparities in education are greatest in rural areas and among the poor. The gender gap increases with level of education. Notably, the fastest increase in school enrollment is for girls from the poorest communes. However, survival and education completion rates remain lower for girls.
- Women in Cambodia have poor nutritional status and maternal mortality in Cambodia is among the highest in the region. Approximately 2,000 Cambodian women die each year of pregnancy and childbirth-related causes (calculated as an approximation based on maternal mortality and crude birth rates), including deaths due to abortion, hemorrhage and eclampsia. Similarly, infant mortality rates are also much higher than, for example, in Viet Nam, China or Thailand.

## 2.2. The Business Climate in Cambodia

Both the public and private sectors have long recognized the significant challenges faced by the business sector in Cambodia.

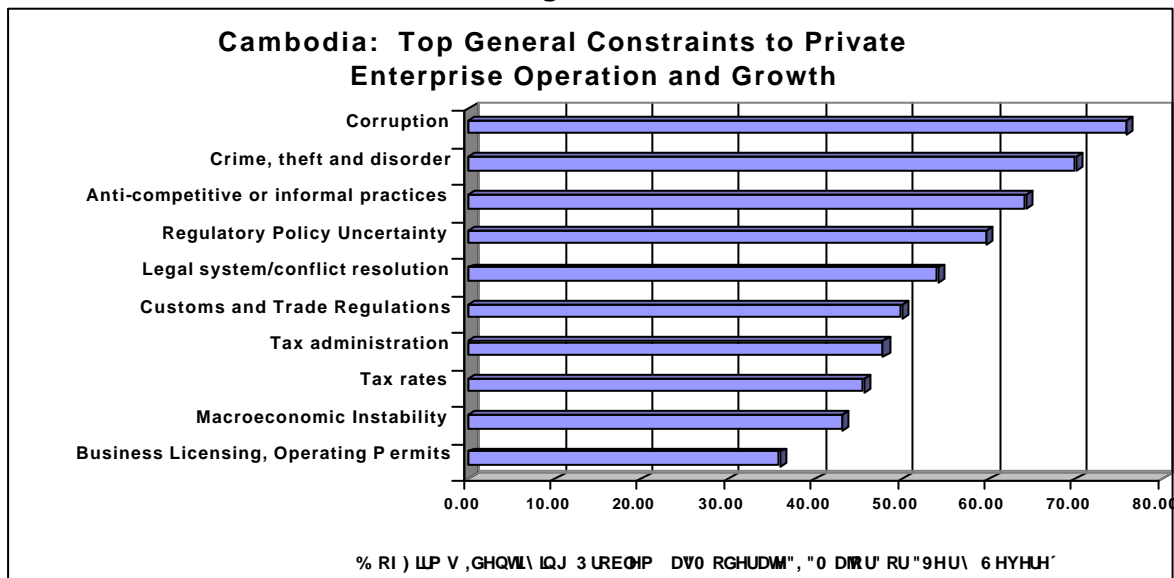
In late 2002, a representative from the Cambodian Investment Board (Hing Thoraxy, 2002) identified the following key issues facing the business community:

- Weaknesses in the legal system;
- Costs of and access to finance;
- Inadequate market information on consumer trends;
- Shortages of skilled labor;
- Inadequate infrastructure that restricts access to markets and raw materials;
- The quality of the port facilities;
- The high cost of essential utilities and services, i.e. electricity, water supply, and telecommunication services; and
- Land issues for agriculture investment projects.

In order to provide a more systematic evaluation of the Cambodian investment climate and to provide policy advice based on both an assessment of the business climate in Cambodia and that of major competitors, the World Bank carried out a Cambodia Productivity and Investment Climate Survey (PICS) in 2003. The PICS is analyzed in World Bank, 2004, and represents by far the most comprehensive evaluation of the investment climate in Cambodia to date.

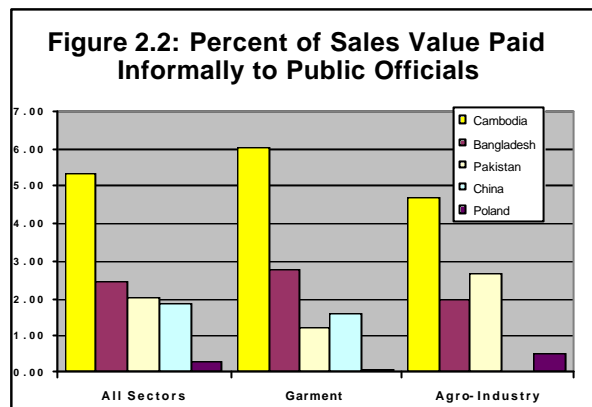
**Overall Evaluation of Constraints.** Overall, the survey found that the top priorities of private companies in Cambodia involved governance, the rule of law, and corruption. Figure 2.1 shows that corruption was ranked as the number one constraint for business, with security as number two, and anti-competitive or informal practices as number three.

Figure 2.1



Source: World Bank, 2004; Data for the year 2003

**Governance and Corruption.** 82% of companies reported that they needed to pay bribes in order to conduct business, and the average level of such payments amounted to between 5% and 6% of total sales. This places Cambodia significantly higher than Bangladesh – at around 50% of Cambodia levels – one of the country’s main competitors in the garment industry. In addition, companies operating in Cambodia viewed the integrity of the bureaucracy as very weak, reinforcing the widely held view that dramatic reforms in all areas of public sector governance are required to improve the business environment.

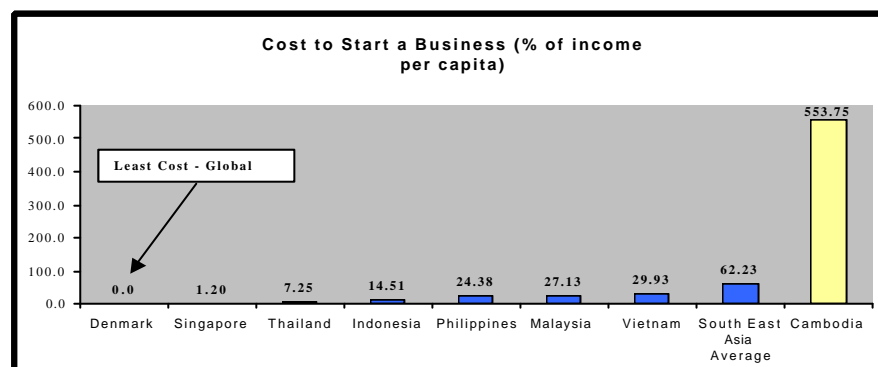
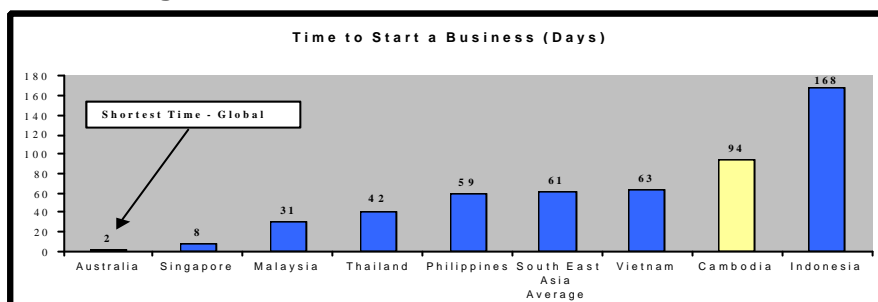


Source: The World Bank, PICS for each respective country.

**Business Operations.**

Two key measures of the ease of doing business concern the time taken to start up a business and the cost of starting up a business. Cambodia scores considerably higher (in terms of time and money) than major competitors in South East Asia, especially in terms of costs.

**Figure 2.3: Time and Cost to Start a Business**



Source: World Bank Doing Business Database; <http://rru.worldbank.org/doingbusiness/>

**Trade Facilitation.** The World Bank clearly identifies the negative aspects of trade facilitation – high costs of corruption and long delays for clearance procedures – as a critical issue affecting productivity and competitiveness in Cambodia, with each step in the exporting process characterized by delays, formal costs and informal payments. In addition to the time taken, companies particularly object to the arbitrary nature of the procedures that are seen as unclear and often superfluous. Again, it is found that Cambodia scores lower even than Bangladesh in terms of the longest time taken to clear customs. In the garment industry, for example, it takes up to 19 days in Cambodia to clear customs, while in Bangladesh it takes only 14 days.<sup>6</sup>

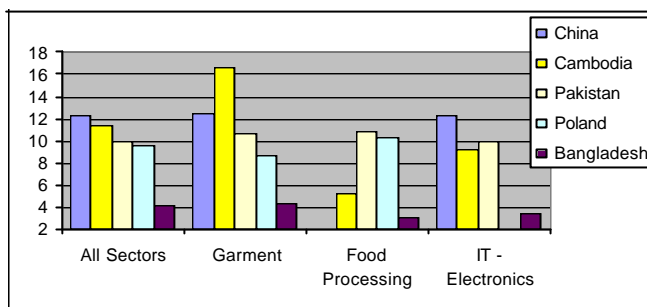
**Regulatory Environment.** Factory inspections, especially related to tax matters, and arbitrary interpretation of policies and regulations create serious burdens on companies operating in Cambodia. In particular, Cambodian companies face an average of 16 government inspections per year, compared to 14 in China and only 8 in Bangladesh. In terms of management time spent in dealing with regulations, Cambodia overall fares slightly

<sup>6</sup> Sources: World Bank Productivity and Investment Climate Surveys for Cambodia and Bangladesh.

better than China, but much worse than Bangladesh. However, if the garment industry is singled out, then Cambodia is worst, with managers spending over 16% of their time dealing with regulatory matters.

**Other Constraints.** Although not mentioned by companies as among the top constraints, other factors affecting business include a range of issues relating to: access to capital and finance; availability of skilled and managerial workers; availability and quality of infrastructure – power, telecommunications, water and sanitation, transport; and logistics services.

**Figure 2.4: Percentage of Management Time Spent on Bureaucracy**



Source: The World Bank, PICS for each respective country.

In conclusion, it is interesting to re-state the major findings of a survey of Cambodia's private sector in 2000 (Mekong Project Development Facility, 2000), which concluded, "The findings of this survey give cause for both optimism and concern. Cambodia is gaining benefits from an outwardly pro-business government, but suffers from dilapidated infrastructure, widespread corruption, looming competitive pressures from its neighbors, and very weak or non-existent business support institutions." These observations remain surprisingly accurate in 2004, and there is no doubt that, as the international business environment becomes more competitive as the textiles and clothing quota system is dismantled, Cambodia will need to carefully and urgently address these critical impediments to investment.

### 2.3. Garment Industry Trends and Projections

The global textiles and clothing industry has developed into a major activity in many countries that previously had little or no manufacturing sector, and this is the case in Cambodia. In order to understand the background and possible future of the garment industry this section of the report examines the general implications of the ending of the quota system, looks at future market trends, and considers changing agendas in market access, especially in view of China's accession to the WTO and more complete entry into the global garment market.

#### 2.3.1. The Quota System and Implications of its Ending

The global textile and garment industry has expanded continuously to meet the demands of a growing world population with increases in standards of living worldwide and diversification of end-use applications. In 1950, for example, the consumption of fiber by the world's textile mills was 7 million tons – and that increased to almost 55 million tons in 2003. It is interesting to note that polyester, first discovered by The Calico Printers' Association in Manchester, UK in the early 1950s, now represents about 65% of total fiber consumption, i.e. about 36 million tons.

The principle end-use applications for textiles fifty years ago were in the manufacture of garments (about 84%) and home textiles, e.g. bed linen, furnishings, towels, etc., (about 12%) whilst other end uses represented some 4%. Today, one of the key growth areas for textiles is in industrial textiles, e.g. fabric substrates for the production of shoes, airbags for cars, buses, etc., and in technical textiles, e.g. geo-textiles, agro-textiles, and construction textiles.

The Multi-Fiber Arrangement (MFA) was introduced by the major, high cost textile and garment industries in the late 1960s—early 1970s as a means of protecting their declining textile industries by restricting imports from the then established textile and garment exporting countries, e.g. China, Egypt, Hong Kong, India, Republic of Korea, Pakistan, Taiwan, Thailand, Turkey, etc. The quantitative restrictions, known as quotas, were introduced through bilateral negotiations or, if discussions failed to reach agreement, restrictions were imposed unilaterally. The objective of the quotas was to enable the textile and garment industry capacities in the higher cost countries to be reduced at a controlled rate. This reduction has taken place over the last 30 years.

One of the apparently incidental results of the MFA has been the transfer to, and growth of textile and garment industries in, many countries that previously had no significant textile or garment manufacturing traditions and, therefore, also had no restrictions on their exports. These countries include Bangladesh, Indonesia, Malaysia and Sri Lanka. Cambodia is one of the later entrants to the global export market with garment export sales first recorded in the middle 1990s. Cambodian garment production, while critical to the economy of Cambodia, remains relatively small in global terms with about 0.3% of garment production worldwide and 0.7% of global foreign trade, by value, based on WTO data.

In 1995, the Uruguay Round of negotiations was concluded and the stage set to enable all world trade to return to the General Agreement on Tariffs and Trade (GATT). This involved replacing the Multi-Fiber Agreement (MFA) with the WTO Agreement on Textiles and Clothing (ATC). The ATC is based on a non-extendable 10-year transitional program for the removal of all quotas by 1 January 2005. The critical aspects of the ATC were that the higher cost countries' importers had a further 10 years in which to make the needed commercial, industrial and social adjustments in reducing their production capacities and that the exporting countries had the same 10 years in which to prepare their business strategies to be competitive in the new market situation.

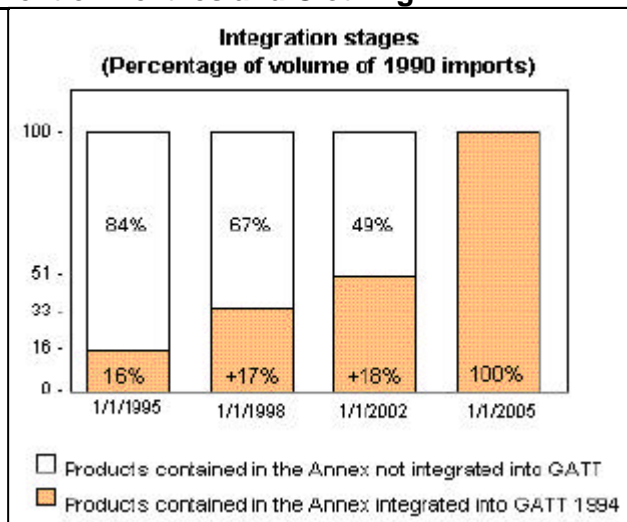
**Box 2.1: The WTO Agreement on Textiles and Clothing**

The completion of the Uruguay Round of negotiations resulted in an agreement to integrate trade in textiles and clothing into the GATT/WTO. In 1995, the Multi-Fiber Agreement (MFA) was replaced by the WTO Agreement on Textiles and Clothing (ATC). The ATC is based on a non-extendable 10-year transitional program for the removal of all quotas by 1 January 2005.

Liberalization has proceeded along two paths. One concerns integrating textile and clothing trade into the WTO framework and the other is related to the application of accelerating growth factors for MFA quotas. The ATC is binding only for WTO Members and is subject to the same set of rules and a single system of resolving disputes, which is applicable to all WTO Agreements.

The ATC calls for a gradual phase out of the quota restrictions carried over from the MFA regime. Products covered by the ATC have been integrated in three stages and the percentage of products that must be brought under GATT rules are specified for each step. If any of these products come under quotas, then the quotas must be removed at the same time. In these three stages, the quota growth rates increase progressively from their base levels by increasing annual growth rates at each stage. Products brought under GATT rules at each stage were required to cover the four main types of textiles and clothing: tops and yarns; fabrics; made-up textile products; and clothing.

Source: Adapted from UNIDO 2003.



The key date for the garment industry worldwide is 1 January 2005, by which time MFA quotas will be finally phased out. See Box 2.1 for more details.

Despite the ending of the quota system, countries that are members of Free Trade Agreements (FTAs) and Regional Trade Pacts (RTPs), e.g. EU, NAFTA, SAARC, and ASEAN, will continue to enjoy market entry advantages through zero rated import duties that may not be available to non-members, and preferential access will still be provided by the major market countries to less-developed countries. In addition, some non-tariff barriers will be applied by buyers when selecting their preferred suppliers, depending on employment conditions, child labor, social compliance, the levels of service provided, delivery reliability, protection of the environment, etc. Safeguard measures can still be applied for some periods of time in the event that free trade would significantly disrupt markets<sup>7</sup>. Additionally, buyers are showing preference for garment suppliers that have either their own or domestic material supplies, through integrated or partially integrated textile value chains, so that lead times may be reduced and delivery times are more likely to be honored.

Speculations on the implications of the ending of the quota system have been widespread and any firm conclusions must be treated with care, except that quotas will definitely end on 31 December 2004. As pointed out in Van, 2003, “a magma of confusion still reigns supreme” despite many meetings of industry stakeholders and studies<sup>8</sup>.

Nevertheless, by linking the ending of the quota system with the following garment industry trends, some useful insights can be derived:

- Cost competitiveness will continue to be a key factor as garment prices are expected to continue to fall after 2004.
- Buyers are requiring faster deliveries to meet increasing levels of consumer demand and ever decreasing product cycle times. This will place greater emphasis on countries that have more complete supply chains and are able to meet these increasing demands<sup>9</sup>. It is noticeable that many garment supply countries have recently made strategic investments to ensure that their supply chains are ‘complete’.
- Buyers want business to be as straightforward and uncomplicated as possible. They will have a greater choice post quotas and they will buy from preferred suppliers who offer consistent quality, reliable delivery, competitive prices, and productivity levels at international standards. Buyers will seek greater value-added service requirements.
- Foreign investors will have more freedom in where to place their offshore investments and prefer host countries that enable them to operate successfully with minimum complications.
- In general, the global garment market has been demanding higher levels of (a) personal service, (b) quality consistency, (c) delivery lead times, (d) product innovation, (e) price competitiveness, (f) reliability, and (g) country image (including compliance with corporate codes of conduct).

Given these general trends and the ending of the quota system, it is highly likely that certain predictable changes in global demand and supply will be observed, and that the resulting major changes in demand and supply will benefit some countries but badly affect others.

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<sup>7</sup> See Mekong Capital, 2003 for a discussion of potential safeguard measures.

<sup>8</sup> Van reports on a major EU-organized meeting in May 2003, and cites two major conclusions: (a) the big importing countries will reduce the number of garment supplying countries, and by extension companies, from the current level of over 100 to less than 50; and (b) the larger nations with an integrated textile industry, including cotton-growing facilities, would likely emerge as the major beneficiaries from the quote-free environment.

<sup>9</sup> Mekong Capital, 2003 highlights this point as well as the related one that countries with deeper supply chains will be able to meet the rules of origin of the major market access schemes more easily and thus enter these markets free of duty.

In this instance, those that benefit will be garment manufacturing companies in countries that have preferential market access and meet buyer requirements in terms of service reliability, quality, production flexibility, lead times for initial and repeat orders, and can demonstrate that they understand the market's needs with targeted new designs. In particular, the strong traditional textile and garment exporting countries, e.g. China, India and Turkey, whose exports have been restricted by quotas negotiated with the importing countries, will be able to increase their exports provided they are competitive. Garment exports will increase, but textile exports probably will not increase since the intention will be to convert as much as possible of textile production into exportable garments and home textiles. New textile and garment exporting countries, e.g. Bangladesh, Cambodia and Lao PDR, will be able to further increase exports, mainly of garments, provided they can offer customers high levels of service, quality and consistency, and meet market demands in terms of both prices and lead times. In the case of Cambodia and Lao PDR, it is perhaps the latter point that will be the major challenge since garment companies in countries with primary textile capacities will be in a better position to source materials domestically and supply garments more quickly. Companies without domestic fabric suppliers will be at a disadvantage.<sup>10</sup>

Those most badly affected will be companies in higher cost countries that are no longer cost competitive. As quotas come to an end, more textile and garment production capacities will close down in the higher cost countries and garment imports, together with home textile (bed linen, towels, furnishings, table linen, etc) imports, will increase. In addition, textile imports will decline since there will be less manufacturing capacity remaining in these higher-cost locations that use textiles as raw materials. The residual industry in the higher cost countries will produce niche, specialty or technical products that need to be close to the markets.

Also among those badly affected will be companies in lower cost countries that are unable to serve buyers satisfactorily. Some garment companies that have been regular suppliers to the markets under the quota regime will fail in the new market environment, as their strengths until now have been geared to their 'ownership' of annual quota allocations and not to serving their customers. Box 2.2 presents the findings of a report on the expected impact of the ending of the quota system on Bangladesh, one of Cambodia's major competitors.

**Box 2.2: Impact of the Ending of Quotas on Bangladesh**

The Bangladeshi industry relied on three major factors for the rapid growth of its garment industry in the 1990s: low wages, initial FDI inflows, and favorable market access in major markets compared to its competitors. However, the existence of generous rents was seen to have weakened incentives to increase productivity. There also remain serious structural weaknesses in the economy, mainly weak infrastructure, high costs of lending, and inflexible labor markets.

The simulation model shows that Bangladeshi exports are highly vulnerable to the final stage of the phasing out of quotas, and under certain assumptions exports may fall by up to 40% from a baseline scenario. The report emphasizes that, while important factors exist that are beyond the control of the government, the most reliable ways of maintaining Bangladesh's current market share are to remove the various supply constraints and promote increases in the productivity of the textile and garment industries.

The conclusion of the report is illuminating: "Bangladesh faces a serious challenge in maintaining its competitiveness in a post-ATC era. This challenge should serve as a wake-up call for policymakers. With its vast labor resources, Bangladesh has potential to expand its exports of RMGs and other labor-intensive exports if its key structural weaknesses can be overcome. Bangladesh needs to make determined efforts to raise productivity through accelerated structural reforms."

Source: Derived from Mlachila and Yang, 2004.

<sup>10</sup> Related to this question is the issue of whether or not there will sufficient yarns and fabrics (grey or finished) available on the open markets to feed into the garment companies in non-textile producing countries. There is the possibility that countries producing textiles (yarns and fabrics) will convert all fabric production into garments themselves. While this report does not take this view, the possibility does need to be borne in mind.

### 2.3.2. Market Trends and Projections

The changing demand and supply patterns will result in an increase in foreign trade in garments from US\$202 billion in 2002 to US\$250 billion in 2005 and US\$320-US\$350 billion in 2010 on a production substitution basis. The exact value of foreign trade will depend on the economic conditions prevailing globally over the next few years.

Table 2.1: Global Foreign Trade in Garments							
Top Exporting Countries (Actual and Projected, US\$ bn)							
		1990	1995	2000	2002	2005	2010
<b>Total Trade</b>		108.1	158.3	197.0	200.9	250.0	320.0
<b>Of which:</b>							
<b>EU</b>		40.8	48.5	47.5	50.5	45.0	30.0
<b>China</b>		9.7	24.1	36.1	41.3	50.0	65.0
<b>Hong Kong</b>		9.3	9.5	9.9	8.3	7.5	6.0
<b>S. Korea</b>		7.9	5.0	5.0	3.7	3.0	1.8
<b>Taipei</b>		4.0	3.3	3.0	2.2	1.9	1.4
<b>Thailand</b>		2.8	5.0	3.8	3.4	3.2	2.5
<b>Turkey</b>		3.3	6.1	6.5	8.1	9.4	12.5
<b>USA</b>		2.6	6.7	8.6	6.0	5.0	3.5
<b>India</b>		2.5	4.1	6.2	5.9	6.9	8.8
<b>Bangladesh</b>		0.6	2.0	4.2	4.1	4.8	6.1
<b>Pakistan</b>		1.1	1.6	2.1	2.2	2.6	4.0
<b>Indonesia</b>		1.7	3.4	4.7	4.0	4.6	6.0
<b>Hungary</b>		0.4	1.0	1.2	1.3	2.5	3.0
<b>Viet Nam</b>		0.3	0.5	0.9	1.0	1.5	4.0
<b>Canada</b>		0.3	1.0	2.1	2.0	1.8	1.1
<b>Malaysia</b>		1.3	2.3	2.3	2.0	1.8	1.3
<b>Mexico</b>		0.6	2.7	8.6	7.8	6.9	5.4
<b>Morocco</b>		0.7	0.8	2.4	2.4	2.8	3.9
<b>Philippines</b>		1.7	2.4	2.5	2.6	3.0	3.9
<b>Sri Lanka</b>		0.6	1.8	2.8	2.3	2.5	3.0
<b>Tunisia</b>		1.1	2.3	2.2	2.7	3.1	5.0
<b>Cambodia</b>	Value	0.00	0.03	0.90	1.30	1.76	2.60
<b>(growth case)</b>	Share of total	0.0%	0.0%	0.5%	0.6%	0.7%	0.8%

Source: WTO and project projections

Table 2.1 detailing top garment exporting countries shows that until now the major garment exporter has been the EU but that this supplier has been in decline in the past few years. Further declines in EU production and exports are expected. The table also shows that garment exports from high- and medium- cost countries are in decline, e.g. from the US, Canada, Hong Kong, South Korea and Taiwan. Some newly industrializing countries such as Thailand and Malaysia have moved into electronics that pay higher wages and so their garment industries are no longer cost competitive.

China has ambitious plans for its textile and garment exports, based largely on foreign direct investment and attractive local costs (e.g. power, transport, etc), and has increased its exports from US\$10 billion in 1990 to US\$42.3 billion in 2002. Plans are for garment exports of US\$50 billion in 2005 and further growth thereafter.

However, it may be noted that China's garment export plans for 2005 represent only 20% of global foreign trade and China's entry into the US and EU markets may be subject to temporary safeguard measures. This means that 80% (some US\$200 billion) remains available for other exporting countries to share. Typically, fiber-producing countries such as

India, Indonesia, Morocco, Pakistan, Turkey, etc. are gearing their industries to increase garment exports. Non-textile fiber producing countries are also planning to increase their garment exports, often by building backward linkages to improve their delivery lead time competitiveness, e.g. Bangladesh, Madagascar, Mauritius, Sri Lanka, etc. Viet Nam will become a stronger garment exporter once it meets the requirements for WTO membership.

Eastern European countries (i.e. Czech Republic, Hungary, Poland, Romania, etc.) have all increased garment exports during the last 15 years on the basis of Outward Processing Trade (OPT) work from Western European garment producers. Italy and Germany in particular have built up more competitive garment operations, especially for tailored garments. However, as the EU expands it is expected that manufacturing costs in Eastern Europe will also increase and that these opportunities will only last for a few years. Egypt and Syria have significant indigenous cotton crops that are mainly sold as lint cotton at present. Both countries are formulating plans to convert more of the crops into value added products.

There are a number of smaller garment producing countries in the region with industry profiles similar to that of Cambodia, such as Lao PDR and the Fiji Islands. They have foreign-owned garment industries dependent on offshore owners supplying production orders, fabrics and accessories to fill their stitching capacities. The host countries offer product quota advantages, competitive wages and preferential market access provided by the importing countries, e.g. the US, EU, Canada, Norway, Australia and New Zealand. The host countries include the AGOA and Caribbean countries, LDCs and other African, Caribbean and Pacific (ACP) countries (now Cotonou countries) not included in the other categories. The value to offshore owners of the garment-manufacturing units in some of these countries will undoubtedly change in coming years and this is of concern, especially when considering the future advantages of the Cambodian industry.

Table 2.2 detailing global importers shows that more than 85% of garment imports over the years, and at least since 1990, have been bought consistently by the EU, USA, Canada, Japan and Mexico. There is every expectation that these same countries will continue to be the major markets. If Australia, New Zealand, Norway and Switzerland were to be included in this list, the share of global garment imports taken by these countries would exceed 90%.

<b>Table 2.2: Global Foreign Trade in Garments</b>						
<b>Top Importing Countries (Actuals and Projections, US\$ bn)</b>						
	<b>1990</b>	<b>1995</b>	<b>2000</b>	<b>2002</b>	<b>2005</b>	<b>2010</b>
<b>Total Trade</b>	108.1	158.1	197.0	200.9	250.0	320.0
<b>Of which:</b>						
<b>EU 15</b>	56.8	74.2	80.2	84.9	100.0	124.0
<b>USA</b>	26.9	41.4	67.1	66.7	78.0	105.0
<b>Canada</b>	2.4	2.7	3.7	4.0	4.6	6.0
<b>Mexico</b>	0.6	1.9	4.0	4.1	4.8	6.5
<b>Japan</b>	8.7	18.8	19.7	17.6	23.5	31.0
<b>Sub-total</b>	95.4	138.9	174.7	177.3	212.9	272.5
<b>% of total</b>	88.3%	87.9%	88.7%	88.3%	85.2%	85.2%
<b>Other countries</b>	12.7	19.2	22.3	23.6	37.1	47.5
<b>% share of others</b>	11.7%	12.1%	11.3%	11.7%	14.8%	14.8%
Source: WTO and project projections						

Under the new market regime, all WTO member countries will open their borders to garment imports, so global foreign trade will logically increase. It is anticipated that all other countries, including Russia and China, will share the balance of foreign trade (US\$25 billion in 2005 and US\$35 billion in 2010).

The cost competitiveness of garment supply countries in the two major market areas will change considerably with the ending of quotas. Until now, as shown in Table 2.3, several countries have sold quotas to their garment manufacturing companies (or the companies have bought quotas from their respective governments). The cost of these quota premiums has been recovered from the eventual garment buyers. Without quotas, vendors will be able to reduce prices accordingly, as shown in Table 2.3. It can be seen that Cambodia in particular will lose some of its cost competitive advantage as quotas end and competing countries are able to adjust their prices, especially China.

	(percent)			
	<b>Textiles</b>	<b>Textiles</b>	<b>Clothing</b>	<b>Clothing</b>
<b>Market</b>	<b>EU</b>	<b>USA</b>	<b>EU</b>	<b>USA</b>
<b>India</b>	1.0	3.0	20.0	20.0
<b>Pakistan</b>	9.4	9.8	9.2	10.3
<b>China</b>	1.0	20.0	54.0	36.0
<b>Hong Kong</b>	2.1	0	12.3	2.3
<b>Sri Lanka</b>	1.0	0	0	7.0
<b>Cambodia</b>	0	0	0	0
<b>Other East Asia</b>	1.0	0	0.3	2.5
<b>Other South Asia</b>	1.0	0	3.0	7.0
<b>Bangladesh</b>	0	0	0	20.4

Source: World Bank

The increasing competition between major retail buyers in the higher-cost countries will be met by those suppliers who meet buyer requirements. Some buyers will expect to place orders for smaller quantities, whilst others will require faster repeat orders. Other buyers will expect their suppliers to bring new product developments and designs to them, and most will expect to place orders and to receive supplies from within a single country, in order to reduce costs and time. Fiber producing countries will have some advantages in this regard.

It is expected that employment and social compliance issues will become the standard with all supply countries meeting buyer demands<sup>11</sup>. Protection of the environment will also become a greater factor in non-tariff barrier considerations than before, especially with regard to pollution caused by the discharge of dye house waste fluids directly into natural watercourses. Most textile producing countries have environmental protection regulations, but few countries implement them as effluent treatment plants are not yet in place. The high cost of these treatment plants has given added impetus to the creation of industrial estates on which the effluent treatment plant is the hub of all industrial activities.

### **2.3.3. Issues of Market Access and the Role of China**

As quotas in the garment industry are removed completely by 1 January 2005, the issues facing countries in the garment industry with regard to market access shift to a certain extent. This report considers two of the critical issues, namely (a) the role of trade preferences and (b) the role of China. This does not imply that other countries are not a threat; indeed many countries in Asia such as India, Bangladesh, Viet Nam, and others, will compete with Cambodia in export markets (Chapter 3.4). It is simply that China is the largest threat by far.

<sup>11</sup> Cambodia, jointly with the ILO, has undertaken an important project over the past three years to improve labor compliance and labor standards. This is expected to place Cambodia ahead of certain competitors in terms of labor compliance and act as a source of competitive advantage.

**The role of trade preferences.** Since the 1996 Singapore Ministerial Declaration refocused attention on special trade preferences for least developed countries (LDCs), the early 21<sup>st</sup> century saw a proliferation of special unilateral programs to grant preferential access to textile and garment products by all members of the Quad countries (US, EU, Japan, and Canada). These included (a) introduction of the US African Growth and Opportunity Act (AGOA) in May 2000 to amend the US GSP scheme in favor of certain Sub-Saharan African countries, (b) introduction of the Everything But Arms (EBA) amendment to the EU GSP scheme in March 2001, (c) expansion of the Canadian GSP scheme to cover textiles and clothing in January 2003, and (d) revision of the Japanese GSP scheme in December 2000 to cover a wider range of industrial products from LDCs. All of these schemes include some form of rules of origin that producers must meet in order to qualify for preferential treatment. Table 2.4 summarizes the main schemes, the rules of origin, and ideas for improvements.

<b>Table 2.4: A Summary of Major Preferential Market Access Schemes</b>			
<b>Program</b>	<b>Description</b>	<b>Rules of Origin</b>	<b>Possible Improvements</b>
US GSP Until 2006	Duty-free treatment for all products except most textiles and clothing	One single percentage (35%) rule across the board for all products	<ul style="list-style-type: none"> <li>• Extend coverage to all products</li> <li>• Enlarge scope of cumulation to all beneficiary countries</li> </ul>
US AGOA Textile/ Apparel Provision Until 30 Sept. 2008	Selected Sub-Saharan African countries enjoy duty and quota-free access for textiles and apparel	The 35% value-added requirement for AGOA GSP treatment is not required for the textile/apparel provision, but the origin of the fabric and yarn is considered in granting preferential access	<ul style="list-style-type: none"> <li>• Extend coverage to all LDCs</li> <li>• Adopt a single-stage manufacturing criterion for the rule of origin</li> </ul>
EU GSP/EBA	Since 5 March 2001, providing duty-free and quota-free access to all LDCs for “everything but arms”, bananas, sugar and rice	Product specific rules of origin for all products	<ul style="list-style-type: none"> <li>• Replace double-stage transformation for textile and clothing product with a single manufacturing stage</li> <li>• Replace partial regional cumulation with broader coverage</li> <li>• Simplify procedures</li> </ul>
EU/Cotonou	Covering former ACP economies; not Cambodia	Product specific rules of origin for all products	<ul style="list-style-type: none"> <li>• Replace double-stage transformation for textile and clothing product with a single manufacturing stage</li> <li>• Replace partial regional cumulation with broader coverage</li> <li>• Simplify procedures</li> </ul>
Japan Until 2014	Providing duty-free access to almost all products, but very small in terms of coverage (US\$1 bn. in 1991) and utility (30% in 2001)	Product specific rules of origin for all products	<ul style="list-style-type: none"> <li>• Expand cumulation to all beneficiary countries</li> <li>• Revise stringent rules of origin</li> <li>• Simplify procedures</li> </ul>
Canada	Since January 2003, providing duty-free access to textiles and clothing	Product specific rules of origin for all products	<ul style="list-style-type: none"> <li>• Revise rules of origin on textiles and clothing to allow a single manufacturing stage</li> <li>• Simplify procedures</li> </ul>

Source: Adapted from UNCTAD 2003.

In an extensive review of all the major preferential schemes, a recent report by UNCTAD, 2003, highlights a number of key features of these schemes. Overall, in 2001, only 66% of exports from LDCs to the Quad countries were covered by preferential schemes and only 42% of these exports received trade preference at the time of customs clearance. Furthermore, as shown in Table 2.5, the utilization rates in most Quad schemes are rather low, and even when high, such as in the US GSP scheme, they tend to be highly concentrated in a few countries and product areas.

Scheme	Product	GSP Imports (Values, US\$ mn)		Utilization (%)
		Covered	Received	
All Schemes	All Products	7,305	4,920	67.3
US GSP	All Products	2,960	2,836	95.8
US AGOA	Textiles and articles	1,047	375	35.8
EU ACP	All Products	2,059	1,570	76.2
	Textiles and articles	292	252	86.2
EU GSP	All Products	3,936	1,847	46.9
	Textiles and articles	3,186	1,447	45.4
EU EBA For 2002	All Products	6,018	2,325	38.6
	Textiles and articles	3,424	1,847	54.0
Japan GSP	All Products	398	228	57.4
	Textiles and articles	47.5	25.2	53.1
Canada GSP	All Products	11.4	8.0	70.2
	Textiles and articles	3.3	2.5	75.1

Note: all data is for "effective LDC beneficiaries", meaning that trade data is used only from countries that are actively taking advantage of the respective GSP programs.  
Source: Compiled from UNCTAD 2003

These low utilization rates can be attributed to two main factors. First, the complicated procedures and documentation required to take advantage of the preferential access. Second, the existence of strict rules of origin, which make it very difficult for certain countries to qualify for access. In the case of textiles and clothing entering the EU under the EBA scheme in 2001, fully US\$1.6 billion of imports from LDCs paid the 10% MFN duty rate instead of being granted GSP status. As an example, the UNCTAD report states that "countries such as Cambodia have experienced utilization rates of below 10% since 1997."

The three main features of the rules of origin that make them effective barriers to accessing trade preferences. These are: (a) the simple fact that they are complicated, differ from scheme to scheme, and often require complex accounting systems and supervision; (b) the existence of domestic content requirements, which effectively make it impossible to import fabrics except when taking advantage of cumulation arrangements that have been introduced into some schemes; and (c) the requirement that more than one stage of the manufacturing process must be carried out domestically or possibly in partner countries if there is a cumulation scheme in place. In general, these requirements often appear to work against the objective of the preferential access scheme and may even push manufacturers into low-quality, low value-added activities in order to obtain GSP privileges. These requirements also encourage business practices that are contrary to emerging global business trends that are characterized by value chains that freely and increasingly cross national boundaries.

Given the existence of all these schemes and the impending ending of the quota system, it would seem essential that LDCs and recipient Quad countries carefully review the preferential programs in place and, assuming that the rationale for the schemes is still felt to exist, make a number of reforms. UNCTAD 2003 generally proposes the following directions for reforms (see Table 2.4): (a) simplify and harmonize required documentation and

processes; (b) design rules of origin that allow for greater proportions of imported inputs and that are consistent with the industrial structures of LDCs; and (c) broaden the coverage of countries from which inputs can be sourced that qualify for coverage under cumulation schemes.

**The role of China.** This issue has already been mentioned earlier. In a world with no more quotas in T&C and a China that is a member of the WTO, there is little doubt that China will become the world's leading exporter of T&C products in the near future (see Table 2.1 above). Given that this expansion of activities will probably compete heavily with all existing suppliers, traditional market access will be clearly threatened.

In a recent study on the impact of China's accession to the WTO and the ending of the quota system, Spinager and Verma, 2003 (the Consumer Unity and Trust Society [CUTS] report) consider in detail which countries will benefit and which will be badly affected. While Cambodia is not covered in their research, they clearly indicate that those badly affected will be countries that have relied extensively on quota access for their T&C exports. In this regard, Mexico is found to be the worst affected, largely because of heavy reliance on quota-free access to the US and Canadian markets. South Asian economies, such as India and Bangladesh, will also suffer large declines in exports, in effect wiping out the gains that they were projected to experience following quota liberalization.

In order to provide an idea of the extent and speed with which companies based in China will break into previously inaccessible T&C markets once the quota system is lifted, a number of examples are cited. These are: (a) when Canada lifted quotas on woven shirts, sourcing immediately shifted to China from countries like Bangladesh, South Korea, Thailand, and Indonesia; (b) the concentration of the toy industry, which does not face quotas, in Greater China; (c) the rapid increase in the Chinese share of the US market for brassieres after China joined the WTO; and (d) the increase to 60% of the market in suitcases and luggage of textile fabrics by the end of 2002, driving Thailand out of the market.

The CUTS research team interviewed 14 chief executives of major textile/clothing companies and trading houses in Hong Kong in 2000 and followed up in 2003. These executives reported that (a) the competitive position in China will in fact be greater than would be expected from the actual changes in relative prices due to WTO accession, and (b) particularly of concern to countries like Cambodia, they would be transferring most or all operations into China following its membership of the WTO and lifting of T&C quotas. Most of the companies interviewed presently have successful operations in Southeast Asia.

However, there still remains the question whether or not China, however competitive it might be in the T&C sector, can mobilize the level of resources required to increase production in the short-term. If this takes some time there will be some leeway for other T&C exporters to make the necessary improvements, and look to the future niche markets where they can compete with China.

In addition, Spinager and Verma, 2003, highlight the issue that, once the quotas are lifted, it is highly likely that the US and EU will feel it necessary to utilize more traditional safeguard measures or impose dumping and countervailing duties. These measures are quite likely to be taken in response to the expected increase in the inflow of Chinese T&C products into their markets<sup>12</sup>. There is no doubt that such measures will provide a cushion, albeit a temporary one, for T&C exporters that find it hard to compete with China.

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<sup>12</sup> This expectation is also mentioned more recently in Mlachila and Yang, 2004, who hypothesize that such measures (or a newly negotiated agreement between the US and EU and China) would result in China's exports growing by one half of what they would amount to if the system were completely liberalized.

On this topic, a recent report from Oxford Analytica, 2004, highlighted the extensive preparation and restructuring that has taken place in some of the more developed ASEAN economies in preparation for the ending of quotas. The report notes that while India and China stand to gain most in the post-quota era, Thailand, Malaysia, and possibly Singapore, could also benefit if they are able to move up-market and compete at the higher end of the sector. The report identifies Indonesia and the Philippines, however, as being badly affected, since their economies are still characterized by significant disincentives to investment and their T&C activities have not yet been restructured.

### **2.3.4 The Impact of the Ending of Quotas on the Cambodian Garment Industry**

Prior to the detailed analysis of the garment sector in the following Chapter, it is useful at this stage to sum up the main challenges that the Cambodian garment industry is likely to face in the changing market environment.

- **Cost:** Cambodian exporters have nothing to gain from the ending of quotas, since they presently do not pay quota premiums. Effectively, those competitors where quota premiums are now paid will enjoy cost reductions
- **Import prices:** Until Cambodian companies take responsibility for their own future development, realize the necessity of understanding the global market and of offering more specific products/service to the markets with precise strategies, it is difficult to see how Cambodia's garment industry performance in terms of realized prices in the major markets can be improved
- **Competing countries with integrated textile operations** will be better positioned in global markets in terms of lower costs (no transport costs for imported materials); reduced lead times (better shipping schedules) and greater manufacturing flexibility (domestic supplies).
- **Lower labor productivity levels in Cambodia** increase manufacturing costs through lower production, lower quality, and higher material consumption.
- **Shipment delays and additional costs** caused by bureaucracy, including corruption, contribute to reducing competitiveness of the garment industry in an increasingly competitive market.
- **The presumed strengths of Cambodian garment exporters**, e.g. lower costs, market access, quality producers, and high levels of labor compliance, will still exist but are of reducing interest in the new global market as other countries develop these same strengths and also have other advantages.
- **The overall impact of the new global market environment on Cambodia's garment exporters** is expected to be a reduction in exports, re-trenched workers with no alternative job opportunities, and a downturn in the national economy. Urgent action is needed now to prevent this from happening.

## **Part 2: The Cambodian Garment Industry**

### **3. Key Characteristics of the Industry**

This chapter profiles the Cambodian garment industry with sections on: overall contributions of the industry; structure of the Cambodian garment industry and value chains of specific parts of the industry; operational constraints experienced by garment companies, a wide ranging benchmarking of the industry against major competitors; and specific challenges and issues faced by the Cambodian garment industry. The chapter concludes with an examination of market access and regional dimensions of the garment sector.

#### **3.1 The Contributions of the Garment Industry in Cambodia**

##### **3.1.1 Companies, Employment, and Activities**

The Cambodian garment industry has developed extremely rapidly within the last 10 years, from a very minor presence in 1995, to become the major manufacturing activity in the country by the late 1990s and early 21<sup>st</sup> century. In 2003, the garment industry's estimated value added of almost US\$500 million accounted for around 12% of national GDP. The garment industry has an estimated 230,000 employees of which 85-90% is female and in the age group 18-25 years. This accounts for around 65% of total manufacturing sector employment. The estimate of 230,000 persons employed directly in the industry can only be an approximate figure since numbers vary considerably during the course of each year as much trade is seasonal. For a number of companies, for example, if the high season requirement were for a 100% workforce, then the low season requirement is only 60% of that number. The work patterns during the low season are met by arranging for some workers to return to their villages for an extended stay, at retainer wages, by releasing contracted workers at the end of their contracted periods, or by letting permanent employees leave the companies. In addition, there are many indirect jobs associated with the garment industry – perhaps as many as 150,000 related jobs.

The garment industry is estimated to have 196 companies in early 2004, located mostly in Phnom Penh and its suburbs with a few in Sihanoukville, near to the main port, and in Kompong Cham. Fifty-six companies are reported to have closed down since the mid-1990s, so the total number of companies entering the garment industry has been 242. In addition, there are estimated to be a large number of small cottage industry sub-contracting companies that provide extra sewing capacities during peak demand periods. The industry is virtually 100% foreign owned, with most of the decision takers based in East Asia from where production orders are received, together with the fabric, accessory supplies, and delivery instructions. The foreign owners usually have similar stitching units in other Asian countries and decide in which of their units to have garment orders made-up according to quota availability, product quality, manufacturing costs, and delivery lead time.

The attractiveness of Cambodia for foreign direct investment in the mid-1990s was due to the competitive wage cost, no restrictive quotas into major global markets and GSP access to the EU market, with the added advantage that quota premiums that had to be paid in most competing countries were not paid in Cambodia. Consequently, Cambodia had cost competitive advantages over many other countries. As a result, the EU was the main market in the early years. Subsequently, even when some quotas were applied, preferential access to the US market was offered and exports to the US increased significantly.

The garment industry is dependent almost completely on imported yarns (for knitwear); finished woven and circular knitted fabrics (for woven and knitted cut and sew garments); all accessories and almost all packing and presentation materials. The domestic material content is limited to some cardboard cartons and poly bags. As a result, the total average

domestic added value content in 2003 was about US\$ 442 million, i.e. the difference between the value of exports and imports. Expressed as a percentage of exports, this domestic value added content amounted to 28.6%. The garment industry is considered one of the most compliant in terms of labor practices and Cambodia has been awarded incremental increases in quota allocations by the US government (an additional 14% in 2004 of a possible increase of 18%).

### 3.1.2 Exports and Markets <sup>13</sup>

Cambodia's export performance is shown in Table 3.1. Garment exports rose from about US\$26 million in 1995 to over US\$1,600 million in 2003. This amounted to almost 80% of total Cambodian exports, and Cambodia's garment exports represented 0.74% of the world total by value. In 2003, exports to the US broke through the billion-dollar barrier for the first time at US\$1.1 billion, of which 63% were items under quota. However, the US market share of total garment exports from Cambodia has fallen steadily from a peak of 81% in 1998 to below 70% in 2003. This was due largely to the provision of preferential access to the EU in the late 1990s and early 2000s and is reflected in the increasing share of exports to the EU qualifying for GSP privileges in the last three years. Exports to the EU topped US\$407 million in 2003, and following the extension of Canada's GSP scheme to cover textiles and apparel in January 2003, exports to other markets jumped in 2003 to over US\$75 million.

<b>Table 3.1: Cambodia's Garment Exports - 1995-2003, Values and Quantities</b>										
	1995	1996	1997	1998	1999	2000	2001	2002	2003	
<b>Values (US\$ mn)</b>										
US										
Quota					433.3	524.5	501.4	626.5	710.7	
Non-Quota					82.8	226.8	327.2	327.1	410.4	
Total	0.5	1.6	109.9	291.8	516.1	751.3	828.6	953.5	1,121.1	
Share of Quota (%)					83.9%	69.8%	60.5%	65.7%	63.4%	
US Share of Total (%)	1.8%	2.0%	48.4%	81.2%	78.2%	76.2%	71.7%	71.3%	69.8%	
EU										
GSP							143.0	186.4	239.0	
MFN							166.1	169.2	168.4	
Total	25.7	74.8	112.4	63.1	136.7	220.8	309.1	355.7	407.4	
Share of Quota (%)							46.3%	52.4%	58.7%	
US Share of Total (%)	96.0%	93.2%	49.5%	17.6%	20.7%	22.4%	26.8%	26.6%	25.3%	
Other Markets	0.6	3.9	4.8	4.5	7.3	14.3	17.9	28.1	78.7	
<b>Total Garment Exports</b>	<b>26.7</b>	<b>80.3</b>	<b>227.1</b>	<b>359.4</b>	<b>660.1</b>	<b>986.4</b>	<b>1,155.6</b>	<b>1,337.2</b>	<b>1,607.1</b>	
Total Merchandise Exports	865.0	717.0	839.0	795.0	1,124.0	1,394.0	1,564.0	1,742.0	2,056.0	
Garment Share of Exports (%)	3.1%	11.2%	27.1%	45.2%	58.7%	70.8%	73.9%	76.8%	78.2%	
<b>Quantities (pcs mn)</b>										
US										
Quota					118.0	115.2	156.7	136.9	138.9	
Non-Quota					30.0	91.3	110.2	172.3	201.6	
Total	1.3	8.8	62.2	124.7	148.1	206.5	266.9	309.2	340.5	
EU										
GSP							38.5	49.3	67.2	
MFN							42.8	41.0	40.4	
Total	9.0	2.0	34.3	20.7	34.7	58.3	81.3	90.2	107.6	
Other Markets	0.7	2.0	15.2	1.1	3.2	4.4	4.5	7.4	18.2	
<b>Total Exports</b>	<b>10.9</b>	<b>12.8</b>	<b>111.7</b>	<b>146.5</b>	<b>186.0</b>	<b>269.2</b>	<b>352.7</b>	<b>406.8</b>	<b>466.3</b>	
Source: Ministry of Commerce										

<sup>13</sup>

All export data in this section was obtained from the Cambodian Ministry of Commerce.

Table 3.2 shows Cambodian garment export statistics for 2002 and 2003 to the US and EU markets broken by major garment type. Altogether, around 60% of Cambodia's exports in both years were woven cut and sew garments, a single transformation stage product type with minimal domestic value addition. The backward linkage into dyeing and finishing for woven fabrics is capital intensive and uses more power than simple assembly processes. Around one quarter of export sales were circular knit cut and sew garments, for which lead times are falling as competing country suppliers invest in backward linkages (knitting and dyeing and finishing plants). These two parts of the Cambodian garment business are under threat unless access to faster fabric supplies can be assured.

Market	Garment Type	Woven		Circular Knit		Knitwear		Total	
		2002	2003	2002	2003	2002	2003	2002	2003
US	Value	685	785	249	328	20	8	954	1,121
	Share (%)	72%	70%	26%	29%	2%	1%	100%	100%
EU	Value	118	135	47	50	191	222	356	407
	Share (%)	33%	33%	13%	12%	54%	55%	100%	100%
Total (US and EU)	Value	803	920	296	378	211	230	1,310	1,528
	Share (%)	61%	60%	23%	25%	16%	15%	100%	100%

*Notes: Value - US\$ mn. fob. Breakdown not available for other markets.*  
*Source: Ministry of Commerce*

As far as the two major markets are concerned, by product type, around 70% of total US imports from Cambodia in both years were woven garments. Most of the remainder was circular knit cut and sew garments. In other words, almost 100% of exports to Cambodia's major market are single transformation stage garments with critical lead times. The situation in the EU is very different with around 55% of EU imports from Cambodia being knitwear garments in both years; a multi-transformation stage product type with higher labor content and the highest local value addition. The TA project team considers that this is the market segment that will be best suited to the Cambodian economy in the future.

### Exports to the EU by Product

The most important export items to the EU were in product categories requiring export licenses (see Table 3.3): categories 5 (anoraks and sweaters, jerseys), 6 (trousers and shorts) and 4 (knitted shirts, T-shirts and underwear) that together represented 87% of exports to the EU in 2003. The largest export category by far was category 5 in which garments have the largest number of transformation stages in their manufacture and the greatest domestic value addition.

Product category	Product description	Value (US\$ mn.)	Shares in 2003	
			Of Exports Requiring License	Of Total EU Exports
4	Shirts, T shirts - knitted	46.2	12.02%	11.37%
5	Anoraks, jerseys, cardigans	215.9	56.12%	53.11%
6	Trousers, shorts - woven	92.3	23.99%	22.71%
7	Ladies' blouses, shirts	7.1	1.84%	1.75%
8	Men's shirts - woven	7.7	2.00%	1.90%
15	Ladies' coats, anoraks	0.2	0.04%	0.04%
21	Anoraks, overcoats	5.2	1.36%	1.28%
28	Trousers	10.0	2.60%	2.46%
73	Tracksuits	0.1	0.04%	0.03%
	<b>Total</b>	<b>384.7</b>	<b>100.00%</b>	<b>94.64%</b>

*Source: Ministry of Commerce*

Garment exports that did not require export licenses in 2003 were relatively insignificant, amounting to only 5.4% in 2003 by value (Table 3.4). The largest item in this group was product category 78, overalls.

Product category	Product description	Value (US\$ mn.)	Shares in 2003 (%)	
			Of Exports Not Requiring License	Of Total EU Exports
10	Gloves - knitted	0.1	0.35%	0.02%
13	Underwear - knitted	0.7	3.37%	0.18%
14	Coats, raincoats - woven	0.2	0.84%	0.04%
16	Suits, tracksuits - knitted,	0.0	0.02%	0.00%
17	Jackets - woven	0.0	0.07%	0.00%
18	Underwear, bathrobes, pyjamas - woven	1.2	5.44%	0.29%
24	Pyjamas, bathrobes, nightdresses - knitted	1.0	4.47%	0.24%
26	Dresses - woven	1.9	8.59%	0.46%
27	Skirts - woven	0.6	2.88%	0.15%
29	Suits, tracksuits - woven	0.0	0.04%	0.00%
31	Brassieres	0.8	3.68%	0.20%
67	n.a.	0.0	0.00%	0.00%
68	Babies clothes	1.6	7.30%	0.39%
72	Swimwear - knitted	0.2	0.83%	0.04%
74	Ladies suits - woven	0.0	0.09%	0.00%
76	Suits, trousers, overalls	1.4	6.28%	0.34%
78	Overalls	7.6	34.65%	1.86%
83	Coats, anoraks	0.6	2.78%	0.15%
96	n.a.	3.9	18.08%	0.97%
157	Coats, shirts, T shirts, jerseys, knitwear	0.1	0.26%	0.01%
161	Coats, shirts, T shirts, jerseys, knitwear	0.0	0.00%	0.00%
	<b>Total</b>	<b>21.8</b>	<b>100.00%</b>	<b>5.37%</b>

Source: Ministry of Commerce

### Exports to the US by Product

Fabric exports to the US are very limited (Table 3.5), reflecting the insignificant capacity in Cambodia for producing fabrics.

Product category	Product type	2002		2003	
		Quantity	Value	Quantity	Value
218	Coloured woven fabric	36	0.6	0	0.0
220	Special woven fabrics	19	0.0	158	0.1
313	Sheeting	0	0.0	0	0.0
613	Sheeting	6,701	2.8	2,711	1.2
619	Polyester filament fabric	167	0.1	0	0.0
620	Other MMF filament fabric	6,014	2.8	1,067	0.5
625	Poplin/ broad cloth	1,916	1.6	294	0.2
628	Twills/ sateens	445	0.2	0	0.0
666	Other MMF furnishings	22	0.0	0	0.0
	<b>Total</b>	<b>15,319</b>	<b>8.0</b>	<b>4,230</b>	<b>2.0</b>

Notes: Quantity - '000 square meters; Value - US\$ mn. fob.  
Source: Ministry of Commerce

Garment exports to the US under quota categories represented about two-thirds of garment exports in 2002 and 2003 with men's woven shirts and trousers making up over 60% of quota items in 2003 and knitted shirts and blouses accounting for about 31%. As noted previously, knitwear categories – sweaters, pullovers and cardigans – amounted to only 1.2% in 2003, again highlighting the fact that those products with the greatest domestic value addition have only limited exports to the US.

Product category	Product description	Value (US\$ mn.)	Shares in 2003 (%)	
			Of Exports Under Quota	Of Total United States Exports
331/631	Gloves, mittens	0.0	0.00%	0.00%
334/634	Coats - men's	29.1	4.53%	2.86%
336/635	Dresses	7.2	1.12%	0.71%
338/339	Shirts - knitted, men's	159.3	24.81%	15.68%
340/640	Shirts - woven, men's	36.9	5.74%	3.63%
345	Sweaters	5.1	0.79%	0.50%
347/348/647/648	Trousers	349.8	54.48%	34.43%
352/652	Underwear	14.9	2.32%	1.46%
435	Coats - ladies'	0.4	0.06%	0.04%
438	Shirts, blouses - knits	2.5	0.39%	0.25%
445/446	Sweaters	0.8	0.13%	0.08%
638/639	Shirts - knitted	34.8	5.42%	3.43%
645/646	Sweaters	1.3	0.20%	0.13%
	<b>Total</b>	<b>642.9</b>	<b>100.00%</b>	<b>63.19%</b>

Notes: Values do not correspond to total exports in Table 3.1 as some items are not classified  
Source: Ministry of Commerce

Non-quota items represent about one-third of garment exports, with nightdresses, pajamas, dresses, blouses, skirts and babies' garments amounting to about two-thirds (Table 3.7).

It is worth noting that in terms of cotton garments (Category 359), Cambodia became the 10th largest supply country to the US in 2003 in value terms. In the same year, China became the largest garment supply country, replacing Bangladesh. Cambodia's position could improve further in 2004, as quotas have been increased by a 'compliance' approval bonus of 14%, out of a maximum available bonus of 18%. However, since over 70% of garment exports are based on cut, make and trim (CMT) work, in which orders are given (at prices that recently have declined significantly) to garment companies to utilize their general stitching capacities. Many CMT producers around the world have their stitching capacities bought by buyers, or by buyers' agents, so competition amongst sewing companies is severe. CMT business is projected to decline in the post quota era as buyers will be less interested in this business.

In summary, the Cambodian garment industry is in a unique position. Few other countries face a situation in which their garment industry is wholly foreign owned, is almost entirely single-stage low value added manufacturing businesses, where management decisions are almost exclusively taken by distant offshore owners, and the industry accounts for the bulk of manufacturing employment and foreign currency earnings. While about 15% of total garment exports in 2003 were in higher value-added knitwear (mostly to the EU), knitwear sales into the most important US market are almost negligible.

**Table 3.7: Exports to the US of Garments not under Quotas**

Product category	Product description	Value (US\$ mn.)	Shares in 2003 (%)	
			Of Exports Not Under Quota	Of Total United States Exports
237	Playsuits	0.1	0.02%	0.01%
239	Babies' garments	13.5	3.60%	1.33%
336	Dresses	9.9	2.65%	0.97%
341	Blouses - woven	17.9	4.80%	1.77%
342	Skirts	54.8	14.66%	5.40%
349	Brassieres	1.7	0.45%	0.16%
350	Dressing gowns	7.4	1.98%	0.73%
351	Nightdresses, pyjamas	122.3	32.69%	12.03%
359	Other cotton garments	15.1	4.03%	1.48%
360	Pillowcases	1.0	0.26%	0.10%
361	Sheets	1.9	0.50%	0.19%
362	Bedspreads	1.3	0.35%	0.13%
363	Terry towels	0.5	0.14%	0.05%
369	Other cotton goods	2.0	0.53%	0.20%
433	Suit coats - men's	1.1	0.29%	0.11%
434	Coats - men's others	0.8	0.20%	0.07%
442	Skirts	0.3	0.09%	0.03%
443	Suits - men's	1.7	0.45%	0.16%
444	Suits - ladies'	0.0	0.00%	0.00%
447	Trousers - men's	0.5	0.12%	0.05%
448	Trousers - ladies'	0.0	0.00%	0.00%
459	Wool garments - others	0.0	0.01%	0.00%
633	Coats - men's	0.1	0.03%	0.01%
636	Dresses	5.6	1.51%	0.55%
641	Blouses - woven	6.3	1.69%	0.62%
642	Skirts	24.2	6.46%	2.38%
643	Suits - men's	1.6	0.43%	0.16%
644	Suits - ladies'	6.8	1.82%	0.67%
649	Brassieres	1.0	0.28%	0.10%
650	Robes	7.4	1.99%	0.73%
651	Pyjamas	42.6	11.40%	4.20%
659	MMF garments - others	21.4	5.73%	2.11%
666	MMF furnishings	1.2	0.32%	0.12%
670	Hand bags, luggage	0.0	0.00%	0.00%
835	Coats - ladies'	0.0	0.00%	0.00%
836	Dresses	0.4	0.10%	0.04%
838	Blouses - knitted	0.0	0.01%	0.00%
839	Babies garments	0.0	0.00%	0.00%
840	Blouses - woven	0.8	0.21%	0.08%
842	Skirts	0.0	0.01%	0.00%
845	Sweaters	0.4	0.10%	0.04%
846	Sweaters - silk	0.0	0.00%	0.00%
847	Trousers	0.2	0.05%	0.02%
859	Others	0.1	0.03%	0.01%
	<b>Total</b>	<b>374.0</b>	<b>100.00%</b>	<b>36.81%</b>

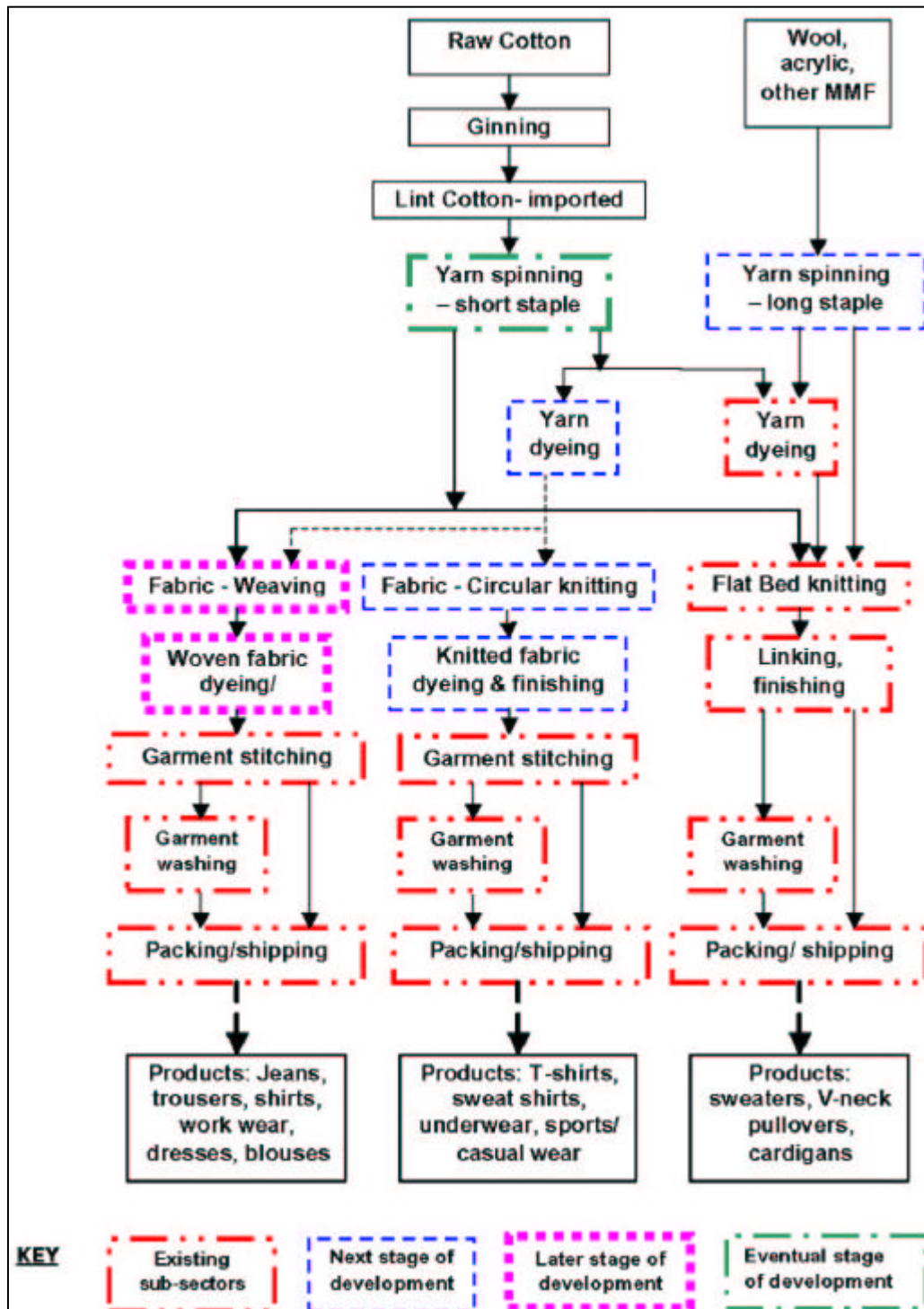
Notes: Values do not correspond to total exports in Table 3.1 as some items are not classified

Source: Ministry of Commerce

### 3.2. The Basic Structure of the Garment Industry

The following section outlines the structure and activities of the Cambodian garment industry within the textile and garment value chain for the three major garment types: (1) woven cut and sew garments; (2) circular knit and sew garments; and (3) knitwear garments. First, however, Figure 3.1 presents a summary of the various positions that the Cambodian garment industry takes in the overall textile and garment value chain. Figure 3.1 identifies the existing sub-sectors, as well as those sectors expected to be developed in the next stage, in later stages, and at the final stage of industry development.

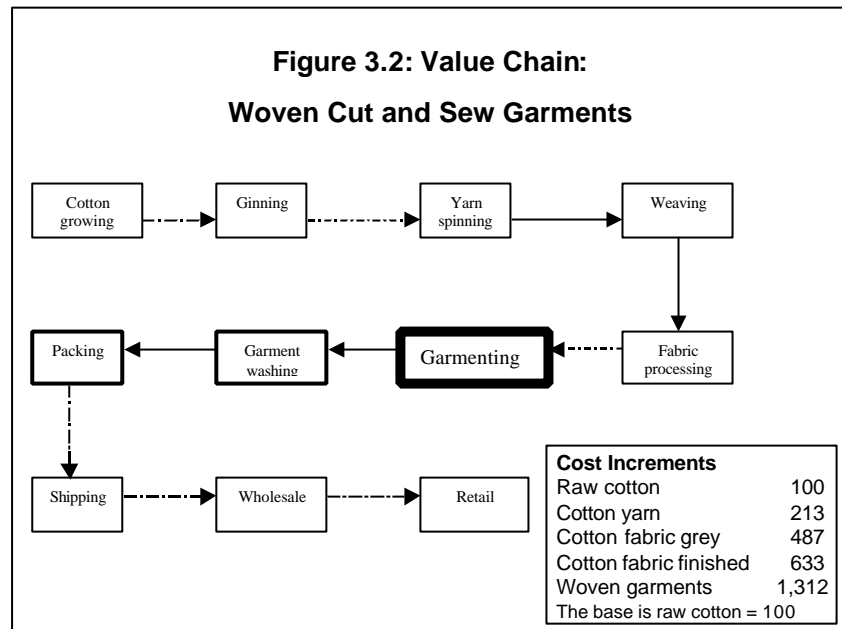
**Figure 3.1: Cambodia's Positions in the Textile and Garment Value Chain**



### 3.2.1. Woven Cut and Sew Garments

The most common woven garments traded internationally are men's and boys' shirts and trousers made from either 100% cotton or polyester/cotton blends. Typically, shirts may be either classical in a limited range of self-colors that changes little from season to season, or fashion shirts made from dyed yarns or prints. Trousers can similarly be divided into classical and fashion garments.

The woven cut and sew garment value chain is illustrated in Figure 3.2. Cambodia's position in the industry is shown in the boxes shown in bold, i.e. garment manufacture, garment washing and packing. Production orders are generated in the head offices of the offshore owners, who determine in which of their manufacturing locations the garments will be made, e.g. in Cambodia, China, Indonesia, Viet Nam, etc, according to availability of quotas, cost, quality and time. The production orders and all garment components are then sent to the selected manufacturing unit for making up and then exported.



The disadvantages of making garments in Cambodia lies in the time and cost of shipping materials to Sihanoukville (via a deep sea port in a third country) and then on to the garment unit; the time and costs of clearing customs (import and export); and the time and cost of exporting the finished garments via Sihanoukville (and on to a deep seaport in a third country).

**Comment:** It is not usual for cotton farming, ginning and yarn spinning facilities to have the same owners as the capacity of a modern ginning mill is considerably greater than of a spinning mill and used for only limited periods of the year. Similarly, it is rare to find garment manufacturing businesses served exclusively by their own woven fabric processing houses as garment production (fashion and usually small production runs) differs from economic textile production (long runs, few machine changes). It is usual for woven fabric process houses supplying fabrics to garment manufacturing companies to be relatively close to each other, to limit or shorten transportation times and associated costs. Shipping, wholesaling and retail activities are not normally the task of the garment companies.

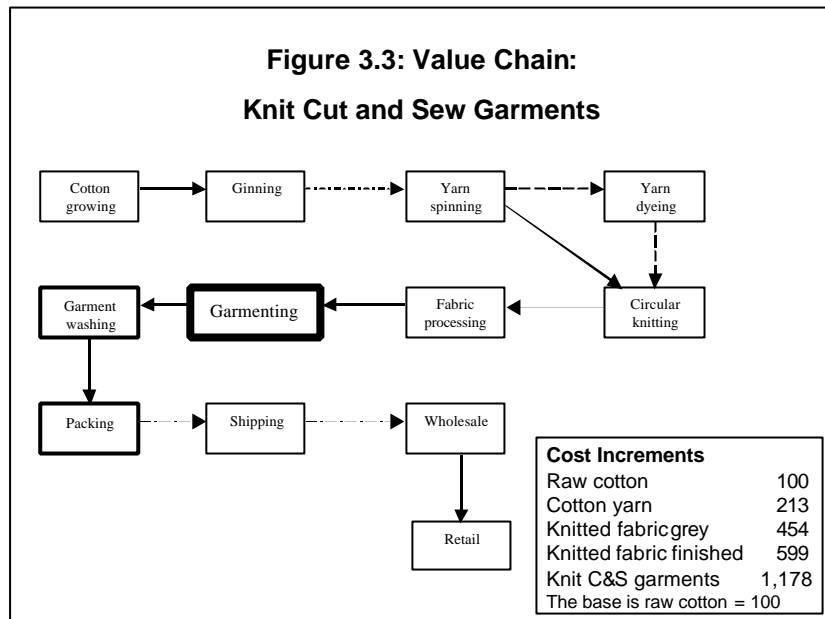
### 3.1.2. Knit Cut and Sew Garments

The present activities of the Cambodian knit cut and sew garment companies are shown in bold boxes in the following illustration of the textile value chain for knit cut and sew garments in Figure 3.3. This sub-sector of the industry represents more than 50% of the global garment market today, with particular growth in the sports and leisurewear segments. It is the sub-sector in which most countries have made investments in relatively limited capital cost

units (an economic size of knitting with dyeing and finishing capacity of 6 tons per day costs about US\$3.5 million).

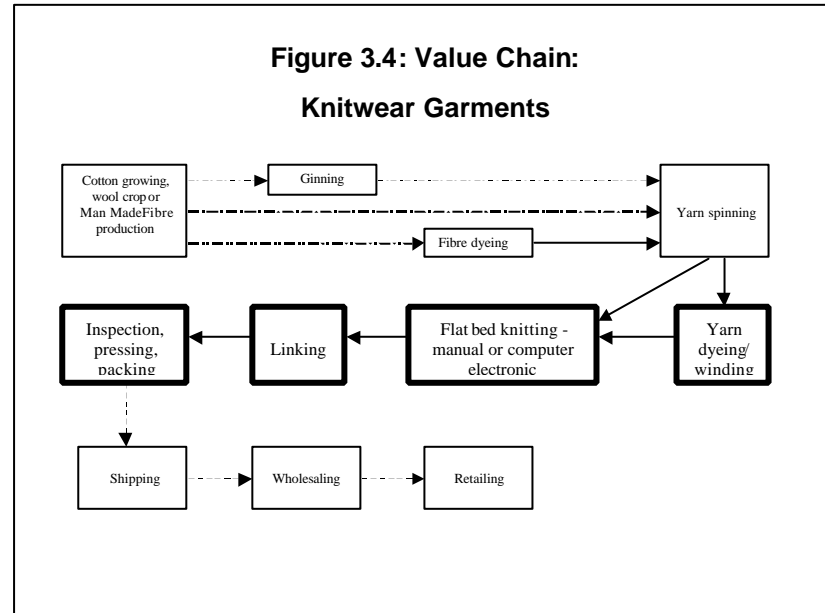
This sector of the global garment industry has become based on such units in order to offer the reduced, competitive lead times demanded by buyers.

It is unusual for yarn spinning companies to be backward linked into ginning or into cotton growing. While shipping, wholesale and retail activities are part of the textile value chain, they are not usually the tasks of garment companies.



### 3.1.3. Knitwear Garments

Knitwear garments may be cotton based or, more often, are based on longer staple fibers such as wool or acrylic. In this case, the yarn spinning system will be different from that used in the other two garment examples, detailed above, where the spinning system is the cotton (or short staple spinning) system. Knitwear garments are labor intensive to produce and have the highest domestic value addition of all garments made in Cambodia. The production steps, based on imported yarns, may include winding/yarn dyeing and re-winding and usually include knitting, linking, control, garment washing or dyeing or finishing, packing, etc.

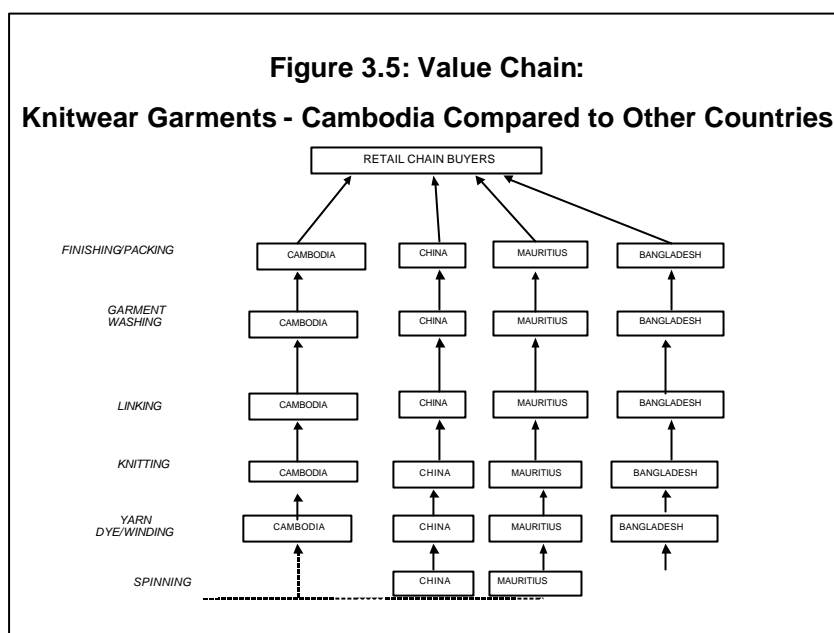


About 90% of Cambodia's knitwear production in 2002 was exported to the EU, although the US is also a major global market for these products. The usual activities of the Cambodian knitwear sector are shown in the bold boxes, although some companies do import knitted garment panels for which the next operation is linking.

It is the standard in other countries for knitwear companies to have their own small spinning and fiber dyeing units, to enable them to bring new colors and new fiber/yarn constructions to the market in relatively limited production runs. As previously stated, it is not usual for cotton growing to be linked directly with ginning, or for yarn spinners to be linked directly to wool or

Man-Made Fiber (MMF) production. As in the previous examples, shipping, wholesaling and retailing activities are usually not directly linked to production unless brand manufacturer owns the business.

Figure 3.5 shows the materials flow in the knitwear sub-sector for four countries: Cambodia, China, Mauritius, and Bangladesh. The figure illustrates the fact that Cambodia is almost as well positioned in this business as the totally integrated manufacturers that also have spinning activities. China and Mauritius have small-sized, 'long staple spinning units for coarser count knitting yarns. Specialty yarns in cashmere, angora, botany wool, etc., are spun. These spinning units are usually smaller than those used in



short staple (cotton) spinning systems. Neither Cambodia nor Bangladesh have these spinning capacities. Although the number of manually operated machines remains high, the number of automated machines is increasing, particularly in China/Hong Kong and Indonesia, as shown in Table 3.8. Mauritius has labor costs that are significantly higher than in the other countries, but has moved into higher value products with specialty yarns.

Country	Manual machines	Automated machines
Bangladesh	14,883	45
China/Hong Kong	28,062	1,910
India	178	70
Indonesia	6,058	1,125
Mongolia	604	10
Mauritius/Madagascar	1,433	71

Source: ITMF (see [www.itmf.org/](http://www.itmf.org/))

As previously mentioned, knitwear garments are a product category that is suited to Cambodia, where competitive wages and (almost) integrated activity is already in place.

### 3.3. Constraints Faced by the Garment Industry

The company-level survey carried out under the ADB TA project confirmed many of the widespread problems facing the industry that were discussed in more general terms in Chapter 2.2, and that have been well documented in several recent studies.

Table 3.9 presents a summary of the six major problems reported by the companies interviewed classified by type of activity. In general, these problems can be classified as (a) operational and (b) structural.

Table 3.9: Constraints Faced by the Industry				
Six Top Issues				
	Knitwear	Woven Cut and Sew	Circular Knit Cut and Sew	Total
<b>Type of Problem</b>				
Procedures	1.28	1.50	1.42	1.38
Corruption	1.39	1.60	1.08	1.35
Recruiting expatriates	3.06	3.20	2.00	2.78
Worker motivation and productivity	2.94	2.20	2.08	2.50
Trades unions	2.72	1.90	1.25	2.08
Lead times	1.78	2.10	1.67	1.83
Number of firms reporting	9	5	6	20
Note: 1 = very major problem; 2 = major problem; 3 = average; 4 = minor problem; 5 = very minor problem				
Source: Expert interviews by project team.				

### 3.3.1 Operational Problems

**Corruption.** Interviewed companies in all garment industry sectors reported major problems with corruption and bribery that result in large additional payments, accounting for up to 7% of the total value of sales. Companies operating in Cambodia are conditioned to having to pay unofficial payments, but the amounts demanded by public sector organizations is reported to be on the increase and to bear no relationship to the size of shipments.

Two particular examples stand out in the garment sector: first, unofficial payments necessary to obtain required export documentation; and second, unofficial additional costs incurred in transporting a container from the factory by road to Sihanoukville Port, through the port, and during loading on to the ship. During transportation of a container from the factory to the ship (on board), the unofficial costs amount to 37.3% of the total cost including unofficial costs (Table 3.10). If shipping costs are excluded, the unofficial costs amount to 74% of the official costs.

**Complexity of import-export procedures.** In addition to unofficial payments relating to import-export procedures, garment companies interviewed confirmed that the bureaucracy associated with importing raw materials and exporting the finished products often results in significant time wasting and unacceptable delays. The amount of time that senior management need to spend on government-related matters represents a serious misallocation of resources.

Table 3.10 draws together examples from the field interviews carried out under the ADB TA project. These examples are typical of the official and unofficial costs (charges) paid by garment companies to secure movement of their goods. While actual values clearly vary from company to company, garment companies pay between 200% to 1,400% in extra unofficial charges to obtain export documents and the time taken for clearance is invariably longer than the official clearance time.

These regulatory practices and corruption serve as deterrents to buyers and investors alike. Both groups know that the unofficial payments situation is unpredictable and could worsen.

**Table 3.10: Extra Costs and Delays: Four Examples**

Example	Official costs and times	Actual costs and times – official plus unofficial																														
<b>1. Export visa - US</b> (Source: Field work interviews)	Cost - US\$30  <b>Total US\$30</b>  Time: 2 days maximum	Cost - Official US\$30 - Unofficial US\$70-80 <b>Total US\$100-110</b>  Time: Up to 1 - 2 weeks																														
<b>2. Export documents - EU</b> (Source: Field work interviews)	Cost - US\$50  <b>Total US\$50</b>  Time: 2 days maximum	Cost - Official US\$50 - Unofficial US\$100 <b>Total US\$150</b>  Time: 7 days on average																														
<b>3. Export visa - US Rush</b> (Source: Field work interviews)	Cost - US\$30  <b>Total US\$30</b>  Time: One day	Cost - Official US\$30 - Unofficial US\$300 <b>Total US\$330- 430</b>  Time: One day																														
<b>4. Transport of one container from factory to ship, including shipping cost</b> (Source: World Bank, 2003)	<table border="0"> <tr> <td><b>Cost</b></td> <td><b>US\$</b></td> </tr> <tr> <td>Transport</td> <td>323.90</td> </tr> <tr> <td>Port charge</td> <td>130.00</td> </tr> <tr> <td>Loading vessel</td> <td>23.00</td> </tr> <tr> <td>Customs</td> <td>331.62</td> </tr> <tr> <td>Shipping</td> <td>3,106.18</td> </tr> <tr> <td><b>Total</b></td> <td><b>3,914.70</b></td> </tr> </table>	<b>Cost</b>	<b>US\$</b>	Transport	323.90	Port charge	130.00	Loading vessel	23.00	Customs	331.62	Shipping	3,106.18	<b>Total</b>	<b>3,914.70</b>	<table border="0"> <tr> <td><b>Cost</b></td> <td><b>US\$</b></td> </tr> <tr> <td>Transport</td> <td>323.90</td> </tr> <tr> <td>Port charge</td> <td>130.00</td> </tr> <tr> <td>Loading vessel</td> <td>23.00</td> </tr> <tr> <td>Customs</td> <td>331.62</td> </tr> <tr> <td>Shipping</td> <td>3,106.18</td> </tr> <tr> <td>Unaccounted</td> <td>2,327.80</td> </tr> <tr> <td><b>Total</b></td> <td><b>6,242.50</b></td> </tr> </table> <p>Unofficial: 37.3% of total</p>	<b>Cost</b>	<b>US\$</b>	Transport	323.90	Port charge	130.00	Loading vessel	23.00	Customs	331.62	Shipping	3,106.18	Unaccounted	2,327.80	<b>Total</b>	<b>6,242.50</b>
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Unaccounted	2,327.80																															
<b>Total</b>	<b>6,242.50</b>																															

**Trade unions.** Companies reported a number of problems with the trade unions that are active in the garment industry. In many cases, differences in interpretation of the Labor Law resulted in serious conflicts arising within the companies. In large part, the business sector attributes these problems largely to ambiguity in phrasing of the articles in the Labor Law<sup>14</sup>. Issues of particular concern include (a) overtime and night shift payments, (b) provision of health services, and (c) existence of numerous trade unions within the same factory, resulting in unnecessary confusion and conflicting objectives. While industrial disputes are less than previously, any dispute is disruptive to the flow of export orders, costly to both workers and companies, and damages the supply reputation of the companies<sup>15</sup>.

<sup>14</sup> An example raised by the industry concerns the phrasing: “Freedom of work for non-strikers shall be protected against all forms of coercion or threat,” and the need for the government to both provide substance to this guarantee and indicate how it can be implemented.

<sup>15</sup> The strong need to immediately implement a review of the existing labor law and make recommendations to improve the clarity and content of the labor law has been emphasized by the garment industry as being a critical element of moves to higher competitiveness.

**Worker motivation and productivity.** Labor productivity is reported to be lower than in competing countries for a number of reasons. These include training methods and low levels of skill development; cultural and communication gaps between workers and supervisors/management; low level of technologies used; low level of worker motivation; the work environment – large sized operations appear to have more problems in motivating workers and achieving productivity levels as high as smaller units with a more ‘family’ atmosphere; unusually high number of public holidays; and health and stress problems. The goal is not necessarily to work harder, but to work smarter, so that all efforts contribute positively to output and less effort is required in negative work, such as repair work and re-checking.

**Recruiting expatriates.** While not ranked as seriously as other problems, companies reported two major difficulties with the need to recruit expatriate supervisors and senior staff. First, the cost of employing expatriates is much higher than employing equally qualified Cambodian workers; and second, expatriate employees face problems in communicating with and understanding the culture of the Cambodian workforce.

**Other factor costs.** In addition to the problems already mentioned, there are also issues related to other input costs that account for around 18% of total costs (see Table 3.11). The main issue here, especially for the more machine driven manufacturing processes, is the cost of power. The cost of electricity in Cambodia (US\$0.15 per kWhr) is about 2.5 times that of the international average of US\$0.06. Investing in a diesel generator reduces the cost to US\$0.10 per kWhr, but this is still high compared to the cost of electricity in other countries.

	<b>Cost</b>	<b>% of Total</b>
<b>Materials and accessories</b>	US\$4.42	65%
<b>Labor</b>	US\$1.02	15%
<b>Other inputs</b>	US\$1.22	18%
<b>Profits</b>	US\$0.14	2%
<b>Total Cost</b>	US\$6.80	100%
Source: World Bank, 2003		

### **3.3.2 Structural Problems**

The major structural problem ranked as very high by the companies interviewed concerned the issue of lead times. This concern was especially serious for knitwear and circular knit cut and sew companies. In a comparative sense, garment lead times from Cambodia remain lengthy, with other major competitor countries able to offer reduced delivery times as shown in table 3.12.

The lead-time issue relates largely to the almost complete absence of backward linkages dealt with in Section 3.5. Cambodia and the garment industry must not ignore the changes to supply chains that are taking place around the world, partly as a result of the changing trade environment. As other countries have done, investments in Cambodia in up-stream parts of the textile supply chains should be encouraged in order to provide shorter lead times, improve competitiveness, increase the number of direct and indirect jobs in the textile/garment industry, and raise the domestic value added content of exports.

<b>Table 3.12: Lead Times of Competing Supply Countries</b>		
(days)		
<b>Country</b>	<b>Woven garments</b>	<b>Circular knit garments</b>
<b>Cambodia</b>	90 – 120	90 – 120
<b>Bangladesh</b>	90 – 120	60 – 80
<b>China</b>	40 – 60	50 – 60
<b>India</b>	50 – 70	60 – 70
<b>Indonesia</b>	60 – 90	60 – 70
<b>Malaysia</b>	60 – 90	50 – 60
<b>Thailand</b>	60 – 90	50 – 60
<b>Viet Nam</b>	60 – 90	60 – 70
Source: Gherzi Textil Organisation		

Usually, countries exporting woven garments have an upstream primary textile sector and are able to source their raw materials domestically. As a result, these countries, e.g. China and India, are able to reduce their garment lead times in line with buyer requirements and may be able to reduce lead times further. Bangladesh, however, has only a limited number of backward linkages into woven fabric production and processing and consequently has longer lead times than other countries. To improve lead times, the Bangladesh Government is now offering special incentives to encourage links with domestic garment industry investments<sup>16</sup>.

Almost all the competing countries have invested in circular knitting/knit fabric processing units during recent years and are able to offer the reduced lead times required by buyers. For example, until 6 years ago Bangladesh imported 80% of the finished knitted fabrics required for making garments. After substantial investment, Bangladesh is now 80% self-sufficient in finished fabric supply and imports only 20% of its knit fabric needs.

Cambodia, however, has not made the same investments and is, therefore, disadvantaged. It is likely that this disadvantage will worsen in future when competition between suppliers intensifies and buyers demand shorter lead times.

**Comment:** There is a marked difference in the lead times quoted by garment manufacturers with domestic fabric supplies between woven and knitted garments as a result of the different technologies for manufacturing finished fabrics, as shown in Table 3.12. The strategy of woven fabric producers is to have long production runs with as few machine changes as possible in the course of a year, whilst the strategy of knitted fabric producers is to have some long production runs for maximum efficiency, but also to use the flexibility of the technology to change fabrics to meet buyer needs.

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<sup>16</sup> Interestingly, SAARC cumulation has been rejected in Bangladesh, according to the Government, as (i) the benefit goes to the fabric supply country and not to the garment producing country and (ii) all products, textile and non-textile have to be included in the agreement.

### 3.4. Benchmarking the Competitiveness of the Garment Industry

Given the fact that Cambodia is competing in an increasingly global market, and that the ending of the quota system will make that market even more competitive, this section of the report presents a benchmarking comparison of Cambodia to the following countries: Bangladesh, China, India, Indonesia, Pakistan, Sri Lanka, Thailand, and Viet Nam.

Cambodia's garment industry is the newest of these countries and is now about ten years old. China, India and Viet Nam have long established textile manufacturing traditions going back several centuries, whilst the textile and garment sectors of Bangladesh<sup>17</sup>, Indonesia and Sri Lanka are about 15 to 25 years old. The latter three all started with garment-only industries but recently have invested in backward linkages for selected textile manufactures to feed into their garment companies. Pakistan has grown cotton for centuries but started a textile industry after partition in 1948 and, later, a garment industry following independence. Thailand's textile and garment industry was based partly on indigenous cotton and partly on imported cotton in the beginning, but is now a major player in man-made fiber production.

#### 3.4.1 Market Performance

For the most part, garment companies within these Asian countries are manufacturing garments to the instructions of Western buyers, so that market performance reflects the garment companies' abilities to respond to buyers' needs. Supply performance and market reliability are reflected in higher prices. For example, Hong Kong typically has price realization levels that are 2 to 2.5 times higher than the price realization of India and Pakistan in the importing markets, even though the methods of 'selling' are the same. Cambodian companies have no active direct selling organizations as their head offices make all business decisions, so the score recorded is 5. Until Cambodian companies develop their own business strategies and sales organizations, and are responsible for their own futures, market performance is unlikely to change, as Bangladeshi, Indonesian, Sri Lankan and many Indian garment companies are finding.

Bangladesh has a weak market image for quality and reliability and also offers no new product development which, in the view of buyers, is considered to be a drawback. Indonesia and Sri Lanka have worked hard to improve their market performances with some success. However, costs in Sri Lanka are rising and companies based there known to be planning to re-locate to other countries.

Factor	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Delivery reliability	4 to 5	2 to 4	3	3	3 to 4	2 to 5	3 to 4	3
Active marketing	5	4	3	3 to 4	4	3 to 4	4	4
Active selling	5	4	3	3	4 to 5	4	4	-
Perceived market image	4	4	3	3	3 to 4	4	3	-
Own product styling	5	5	2	3	4	4	3	-

Note: 1 = excellent; 2 = good; 3 = average; 4 = less than average and 5 = weak or poor  
Sources: Project interviews, discussions with buyers, Gherzi Textil Organisation

<sup>17</sup> The Bangladesh industry started following independence in 1971 when East and West Pakistan were separated.

### 3.4.2 Market Access

The respective membership of these countries in preferential market access schemes is shown in Table 3.14. All the countries are WTO members, except for Cambodia (with membership to be finalized in late 2004 when the new government is in place) and Viet Nam (when that country meets the entry criteria). All the countries are also members of either ASEAN or SAARC, and several are seeking membership of other RTPs and FTAs in order to gain entry to more advantageous market entry schemes in global markets. ASEAN is holding membership talks with China, Japan and South Korea in order to widen coverage, and India also wants to join ASEAN. Bangladesh and Cambodia are grouped as least developed developing countries and have GSP entry to the EU, Australia, Canada, New Zealand, Norway and Switzerland. Pakistan believes that it should be similarly classified.

Factor	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
WTO member	2004	Yes	Yes	Yes	Yes	Yes	Yes	No
Status	LLDC	LLDC	DC	DC	DC	LDC	DC	LDC
Access to EU	GSP	GSP	Quota	Quota	Quota	Quota	Quota	Quota
Access to USA	MFN	MFN	MFN	Quota	Quota	Quota	Quota	Quota
Use of Cotonou	0	0	0	0	0	0	0	0
Use of AGOA	0	0	0	0	0	0	0	0
Regional Trade Pact	ASEAN	SAARC	ASEAN	SAARC	ASEAN	SAARC	SAARC	ASEAN

Sources: Project interviews, WTO legislation, ASEAN, Cotonou and AGOA RTP/FTA rules.

### 3.4.3 Export Trade<sup>18</sup>

China is by far the largest garment exporter, based partly on imported finished fabrics and partly on increasing self-sufficiency, through domestic and foreign textile investments. India is second largest of the countries in garment orders, based mostly on domestic textile production and limited foreign investments.

Bangladesh garment exports are the third highest in these countries and have reached a level of about US\$5 billion, building on recent domestic investment in textile production and backward linkages. Indonesia is the fourth largest garment exporter, after having been third largest for some years. Indonesia has invested heavily in MMF production, as well as in textile production, so self-sufficiency in materials supply is also increasing.

	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Exports 1990 US\$ mn	0	643	9,669	2,530	1,646	1,014	638	300
Exports 2000 US\$ mn	985	4,171	36,071	6,178	4,734	2,144	2,812	900
Exports 2002 US\$ mn	1,339	4,131	41,302	5,600	3,945	2,228	2,326	1,000
Share global trade 1990 (%)	0	0.59	8.9	2.3	1.5	0.94	0.6	0.3
Share global trade 2000 (%)	0.5	2.1	18.3	3.1	2.4	1.1	1.4	0.5
Share global trade 2002 (%)	0.7	2.1	20.6	2.8	2	1.1	1.2	0.5

Source: WTO and Cambodian statistics.

Sri Lanka is fifth largest exporter of garments, based largely on foreign investments and imported fabrics but with a high degree of self-sufficiency in knitted fabrics sector. Pakistan has focused more on home furnishing textiles that are more suited to local cottons and garment exports (US\$2.2 billion) are ahead of Cambodia (US\$1.5 billion). Pakistan's garment industry is based almost entirely on domestic investment.

<sup>18</sup> See Section 3.4.11 for a discussion of demand-side competitiveness based on landed prices of the major garment exporting nations into the United States.

### 3.4.4 Marketing and Logistics

Cambodia is disadvantaged relative to the other countries as shown in Table 3.16. Each of the other countries has domestic access to at least some, if not most, of the materials required in the manufacture of garments. This allows for better performance, in terms of on time delivery and rapid repeat orders.

Competitive factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Market orientation- local	5	4	3	3	4	4	4	4
On time delivery	4	3 to 4	3	3 to 4	3	4	3 to 4	-
Fast repeat orders	5	4 to 5	3 to 4	3	4	4 to 5	4	4 to 5
Local yarn supplies	5	3	1 to 2	1	2	1 to 2	3	1
Local fabric supplies	5	3 to 4	2	1 to 2	3 to 4	2 to 3	3	1
Local accessories	5	4 to 5	3 to 4	4	4	3 to 4	4 to 5	3

Note: 1 = excellent; 2 = good; 3 = average; 4 = less than average and 5 = weak or poor  
Sources: Market research for the present and previous projects, interviews with buyers.

### 3.4.5 Manufacturing

Cambodia experiences low productivity in the garment industry, as do Bangladesh and Pakistan to a lesser extent<sup>19</sup>. In terms of product quality and social compliance, Cambodia is one of the leading countries, as shown in Table 3.17. However, recent evidence indicates that other countries have been improving in these areas, so Cambodia's advantage in this respect has been declining.

Competitive factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Productivity	4 to 5	4 to 5	2	2 to 4	3 to 4	4 to 5	2 to 3	3
Quality	2	3 to 4	2 to 3	3	3	3 to 4	2	-
Production flexibility	4	2 to 4	2 to 4	2 to 4	2 to 4	3 to 4	2 to 4	-
Small runs	4 to 5	3 to 5	2 to 4	2 to 4	3	3 to 4	2 to 4	3 to 4
Technology - CAD/CAM	3	3	2 to 3	3	3	3 to 4	3	-
Computerized plan/ control	3	3 to 4	3	3	3	3 to 4	2 to 3	-
Compliance	2	2 to 3	3	3	2 to 3	2 to 3	2	4

Note: 1 = excellent; 2 = good; 3 = average; 4 = less than average and 5 = weak or poor  
Sources: Gherzi Textil Organisation, Study work for this project and previous projects.

### 3.4.6 Labor Skills and Training

In each of these countries there is a plentiful supply of female labor available for garment production. The level of education is generally quite low and operator skills are limited. Most companies in all of the countries prefer to train employees in-house by placing new recruits alongside 'experienced' workers rather than by using in-house training facilities for formal training.

Management training is a general problem and vocational training schools (VTS), especially in the public sector, are not well supported by the garment industry as the curricula rarely matches the needs of the industry. Suitable training of teachers in the VTS should be a priority, so that they can work within companies and train employees in the necessary skills to achieve the needed standards of quality and work speed. Such employee training will create confidence which, combined with individual bonus payment schemes, will bring about motivation. Productivity levels are in serious need of improvement in several countries, as shown in Table 3.18.

<sup>19</sup> See Section 3.5.2 below for a more detailed discussion of this issue

Competitive factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
<b>Gender</b>	Female	Female	Female	Male/female	Male/female	Female	Female	Male/female
Availability	1	1	1	1	1	1	2	1
Education level	4 to 5	5	4	4	4	4 to 5	3 to 4	-
Skills	4 to 5	4 to 5	3	3	3	4 to 5	2 to 3	3
Training facilities in-house	2 to 5	5	3	4	4	4 to 5	2	-
Vocational training schools	4	5	3	4	4	4	3	-
Productivity	4 to 5	4 to 5	2	4	3 to 4	4 to 5	2 to 3	-
Absenteeism	2 to 3	3	2	3	3	3	2	-
Work ethics	2	3	2	2	2	3	2	-
Diligence/dexterity	2	3	2	3 to 4	3	4 to 5	2	3
Compliance	2	2 to 3	3	3	2 to 3	2 to 3	2	4

Note: 1 = excellent; 2 = good; 3 = average; 4 = less than average and 5 = weak or poor  
Sources: ILO country reports, Gherzi Textil Organisation, Project work for this and previous projects.

### 3.4.7 Indigenous Raw Materials

Table 3.14 shows that whilst Bangladesh, Cambodia and Sri Lanka possess no indigenous textile fibers, the other countries have an abundance of cotton, or man-made fibers (MMF), or both. Nevertheless China and Pakistan have to import MMF in order to have the specific material needed for particular garment products and to achieve the necessary price levels. Pakistan imports cotton in order to have the correct lint cotton quality and staple length, whilst Indonesia has only a limited cotton crop and, therefore, needs to import cotton. Bangladesh is totally dependent on cotton imports.

Fibres	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Cotton	5	5	1	1	4 to 5	1	5	2
Wool	5	5	3	3 to 4	4	4 to 5	5	4
Silk	5	4 to 5	1	3	5	4 to 5	5	4
Polyester - staple	5	5	1	3	1	2	5	5
Polyester - filament	5	5	1	2	1	2	5	5
Polyester - micro	5	5	1	4	1	4	5	5
Acrylic	5	5	1	3	3	5	5	5
Nylon (polyamide)	5	5	3 to 4	3	3	3	5	5
Bast	5	1	5	1	4	5	5	5

Note: 1 = excellent; 2 = good; 3 = average; 4 = less than average and 5 = weak or poor  
Sources: World Cotton Statistics, Man-Made Fiber Production Statistics.

### 3.4.8 Infrastructure

Cambodia is poorly positioned in terms of infrastructure compared to the other countries. Both Cambodia and Bangladesh face constraints in that they do not have a deep sea port so all imports and exports need to be trans-shipped through a third country, usually Singapore. All other major competitors have their own deep-sea ports. In addition, while Cambodia's infrastructure weaknesses may not be a major concern with regard to railways and telecommunications, this does become a significant and serious issue when production costs and shipment of goods are severely affected by an insufficient and unreliable power supply and expensive electricity costs.

Competitive Factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka
Roads	5	5	3	2 to 4	1 to 4	1 to 4	2 to 4
Railways	5	4	3	2 to 3	2 to 4	4	none
Airports	4 to 5	3 to 4	2 to 3	1 to 3	1 to 3	2 to 4	1 to 3
Harbors/Ports	5	5	2 to 3	4	2 to 3	3	2
Container terminals	4	4	2	3 to 4	3	4	2 to 3
Telecom	4	3	3	2	2 to 3	2 to 3	2
Customs clearance systems	4 to 5	5	3	3	2 to 3	4	3
Power- shortage	5	5	3	4	3	3 to 4	3
Power supply breakdowns	5	5	4	4	4	4	2
Power cost	4	3	3	5	2 to 3	3 to 4	3

Note: 1 = excellent; 2 = good; 3 = average; 4 = less than average and 5 = weak or poor  
Source: Compiled from various sources. Gherzi Textil Organisation, interviews on the present project.

### 3.4.9 Factor Costs and Mill Operating Hours

Cambodia's labor costs are competitive in both the textile and garment sectors, as shown in Table 3.21. However, overtime rates need to be addressed, as they do not correspond with international standards. It is not usual for garment companies to work more than a day-shift but the capital intensive, machine driven primary textile sector has to operate the maximum number of hours a year. It is quite normal for spinning, weaving, knitting and processing plants to work up to 8,640 hours a year, i.e. 360 days of 24 hours, in order to recover depreciation costs more rapidly and to avoid wastage from machine down time.

Competitive Factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka
Wages (US\$/hr including social charges)							
Textile sector	0.27-0.35	0.30-0.54	0.44-0.76	0.30-0.62	0.30-0.42	0.37-0.42	0.42-0.50
Garment sector	0.27-0.35	0.28-0.36	0.32-0.48	0.30 to 0.45	0.29-0.36	0.32-0.39	0.32-0.40
Power (US\$/kWhr)							
- grid	0.15	0.065	.047-.08	0.1042	.03-.04	.065-.075	-
- own generator				5.83			
Steam - US\$ cents / kg steam	-	-	0.58	1.96	0.75	1.41	-
Raw water - US\$ cents / m3	-	-	15	13.4	5	14.7	-
Mill hours / year - basic							
Textile mill	none	8,400	up to 8,736	up to 8,736	8,400	8,400	8,400
Garment factory	2,304	2,304	2,400	2,400	2,400	2,400	2,400
Majority of workers							
Textile mill	none	Male	Male	Male	Male	Male	Male/Female
Garment factory	Female	Female	Female	Male/Female	Female	Female	Female

Source: Compiled from various sources. Gherzi Textil Organisation, interviews on the present project.

Power costs in Cambodia are very high in comparison to all competitors and will need to be reduced if the primary textile sector is to be competitive. The international standard for electricity costs is about US\$0.06 per Kwhr so that Cambodia's present costs of around US\$0.15 per Kwhr are about 150% too high.

### 3.4.10 Garment Sector Strategies

Each of the selected countries considers their garment industry to be the engine of growth for their national economies, although some countries are more dependent on garment exports than others. For example, Bangladesh, Cambodia, Pakistan and Sri Lanka are dependent on garment exports for more than 70% of their foreign currency earnings. Each of the countries welcomes foreign direct investment (FDI) in the garment and textile sectors in order to bring technical knowledge and market access. Bangladesh and Pakistan have found it difficult to

attract FDI because of their unstable law and order situations and, until recently, the random policy changes and the unstable political situation resulting from government changes. Bangladesh recently changed its investment policy in order to attract more FDI.

**Table 3.22: Benchmarking of Garment Sector Strategies**

Factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
<b>Overall Vision</b>								
<b>Engine of economy</b>	?	yes	with others	with others	yes (non oil)	yes	with others	with others
<b>Target</b>								
<b>Exports</b>	growth	growth	growth	growth	growth	growth	growth	growth
<b>The Means to Achieve Vision</b>								
<b>WTO member</b>	yes	yes	yes	yes	yes	yes	yes	medium term
<b>With FDI</b>	yes	yes	yes	yes	yes	yes	yes	yes
<b>Promote backward linkages</b>								
<b>New investments</b>	proposed	ongoing	ongoing	ongoing	ongoing	ongoing	ongoing	ongoing
<b>Financial support</b>	none	soft loans	-	soft loans	-	-	-	-
<b>Human resources developm</b>	limited	limited	unlimited	unlimited	limited	limited	unlimited	limited

Sources: Study work for this and previous projects, Gherzi Textil Organisation, VISION 2005 (Pakistan), WTO, and other sources.

In addition to seeking better market access and technical knowledge through FDI, each of the countries is taking steps to raise productivity levels and to make backward linkage investments into the textile sub-sectors. In particular, all the competing countries, with the exception of Cambodia, have invested increasingly in textile production in order to have greater self-sufficiency in fabric supplies to the garment industry. Sri Lanka, the competing country with the lowest textile production has made significant investments recently in weaving and in circular and flat knitting capacities. In addition, many governments and business communities are undertaking bilateral negotiations to gain preferential access to the main markets – the US, EU, Canada, and Japan. These include efforts to be deemed eligible for duty-free market access in the US (by a number of Asian exporters, including Cambodia) and also for more favorable (or less restrictive) rules of origin under the EU EBA program.

### **Box 3.1: Some Selected Country Case Studies**

#### **Bangladesh:**

The garment industry in Bangladesh had a similar start in to that in Cambodia but started about 20 years earlier following independence in 1971. By 1990, the country had garment exports of US\$600 million, based almost totally on imported finished fabrics. During the 1990s the industry began to invest in cotton spinning and weaving and especially in balanced circular knitting, knit fabric processing and stitching units of about 5 tons a day. As a result, exports of knit cut and sew garments doubled to about US\$2 billion over 6 years and self-sufficiency in knitted finished fabrics increased from 20% to 80%. This enabled the industry to reduce delivery lead times with an inbuilt flexibility to meet buyer short-term demands for garments. Investments are also taking place in woven fabric production, so that self-sufficiency in finished fabric supply to the domestic garment industry is increasing. The Bangladeshi government now has a soft loan program of US\$200 million to support investment in backward linkages to the woven fabrics sector.

There is, however, one most important difference with Cambodia. Apart from a few early Korean investors who set up garment companies in the Chittagong region to take advantage of Bangladesh being a quota free country at that time, all subsequent investors have been Bangladeshi who, having invested in garment companies or in the primary textile sector when the publicly owned companies were privatized, decided to consolidate their investments with BMRE (balancing, modernization, re-structuring and expanding) and to expand the industry vertically.

Today, Bangladesh has garment exports of about US\$5 billion, mainly to the US and EU under GSP, with a textile supply chain that may have the strength to meet the competitive challenges of the post quota era.

Source: Bangladesh Sector Study 2003, World Bank, Gherzi Textil Organisation.

### Box 3.1: Some Selected Country Case Studies

#### China

The history of the Chinese textile and garment industry is one of exceptional and continuing growth in a climate that is leading the economic changes in the country. China is fortunate in having the second largest cotton crop in the world, 90% of silk produced worldwide, 100% of angora, and most of the cashmere and mohair produced worldwide. China also now has heavy production of man-made fibers, especially polyester.

China has a textile manufacturing and trading tradition going back many centuries. Textile (yarns, fabric and home textiles) imports had reached US\$5.3 billion by 1990 but more than doubled to US\$13.1 billion by 2002. In the same years, textile exports increased from US\$7.2 billion to US\$20.6 billion so that, except for the EU, China was both the largest textile importer and exporter in the world.

The background in garments has been similar. China's garment imports in 1990 were US\$48 million and US\$1.4 billion in 2002, whilst garment exports increased from US\$9.7 billion in 1990 to US\$41.3 billion in 2002.

The reason behind the increase in textile imports and of part of the increase in garment exports has been temporary import for re-export as garments. However, increasingly garment exports are fed by domestic fabric production that has expanded rapidly over the last 12 years with an average of US\$3 billion a year in foreign direct investment. China's target for garment exports in 2005 is US\$50 billion and this is likely to be met. Further growth thereafter is inevitable as investments continue.

However, even at US\$50 billion in garment exports, China will only just have passed the EU as the major garment exporter in the world and US\$50 billion is only 20% of the world foreign trade in garments projected at US\$250 billion for 2005. China has a secured position in garment exports to Japan with a greater than 80% share of Japan's imports. However, China's exports to the US are being closely monitored and will be restricted if growth becomes excessive.

Sources: WTO, Gherzi Textile Organisation, Project work by team.

#### Mauritius

The starting point for growth of the Mauritian garment industry was the Lomé Convention in the early 1980s when 63 African, Caribbean and Pacific (ACP) countries were given quota/ duty free access to West European markets. Mauritius was the first of the countries to take advantage of this, especially with flat bed knitwear garments (sweaters, jumpers). For the last several years garment exports have been around US billion. The garment industry employs about 80,000 workers of which 15% are expatriates from China, Mongolia, India and other countries, as local females prefer to work in the tourist industry. It is estimated that the 14% of expatriate workers generate 40% of exports by value as they elect to work the maximum hours possible to earn more money. However, shipping lines call at Port St Louis irregularly and this creates problems for shipments and tight delivery schedules.

Local and foreign investors united in the beginning to set up joint ventures, based largely on used plant transferred from Europe. A few vertically integrated cotton spinning, weaving and processing businesses were established, as well as some spinning, circular knitting, knit fabric processing and garment units, but finished fabrics were increasingly imported to feed into additional garment companies. The knitwear companies invested backwards as far as long staple spinning to produce knitwear yarns.

In 1990, labor costs were rising and domestic labor was reluctant to work in the garment industry, so many business people decided that there were better opportunities in Madagascar and Southern Africa, where labor costs were lower. A number of companies transferred plant but found low productivity, combined with a political crisis that did not augur well for the future.

When the African Growth Opportunities Act (AGOA) was signed in 2002, Mauritius developed a new textile policy that included incentives to investors setting up spinning and other textile activities, in order to qualify for AGOA country of origin. The Mauritian Government is actively seeking backward linkage investors to ensure that garment companies have materials supplied domestically within short time frames.

Sources: Gherzi (UNIDO) Sector Study report, Mauritian Government's Policy Document 2004.

### 3.4.11 Demand-Side Competitiveness

Consideration has been given above to the importance of supply-side cost factors in Cambodia relative to competing countries. In particular: how low productivity levels in Cambodia negate the advantage of competitive wage costs; how relatively high costs of electricity and fuel oil precludes the possibility of moving into textile production where power cost is the second highest cost factor after raw materials; and how the high unofficial costs of moving goods from the factories and on board ships add some 7% to the final cost.

This section considers Cambodia's competitiveness in the market place from a demand perspective, by comparing the "landed prices" of four major garment product categories from all major supply countries over the same 5-month period in the years 2002, 2003 and 2004.

Landed prices are the prices at which garments are distributed into the US market with all shipping, import duties and port clearance costs paid.

Table 3.23 presents the landed price comparisons between Cambodia and major Asian competitors for the following products: knitted shirts; knitwear; woven shirts; and woven trousers. The situation is remarkably consistent. Overall, with the exception of woven shirts, Cambodia shows landed prices slightly above average for each category. However, among regional competitors, Cambodia realizes among the lowest landed prices in all categories, while performing consistently better than Viet Nam, Bangladesh and Pakistan in all categories, and Indonesia in knitted shirts. For woven trousers, it is interesting to note that all of the named suppliers, with the exception of China but including Cambodia, have increased their average landed prices by at least 10% over the past three years. The result is that the world average landed US prices for trousers have remained stable.

Table 3.23: Landed Price Comparisons in the US Market							
Knitted Shirts				Knitwear			
Market	2002	2003	2004	Market	2002	2003	2004
World	57.0	53.8	54.8	World	46.0	42.3	41.4
China	92.3	80.4	78.2	Hong Kong	93.9	99.1	96.7
Sri Lanka	76.9	78.1	73.1	China	97.6	90.4	87.8
India	63.8	65.6	63.7	Taiwan	54.8	58.3	52.9
Thailand	59.3	60.3	61.8	India	52.8	52.1	52.5
Cambodia	52.1	61.3	55.8	Thailand	49.8	51.0	51.2
Indonesia	59.3	57.8	52.5	Indonesia	59.7	50.8	50.3
Viet Nam	30.1	45.9	45.8	Cambodia	50.3	52.0	43.9
Pakistan	53.3	45.3	44.1	Viet Nam	32.2	37.4	37.4
				Pakistan	39.5	35.6	36.7
				Bangladesh	36.6	36.7	29.3
Woven Shirts				Woven Trousers			
Market	2002	2003	2004	Market	2002	2003	2004
World	68.3	68.5	71.0	World	75.9	77.5	76.9
Hong Kong	102.1	101.7	102.1	Hong Kong	102.9	124.7	122.4
China	81.0	83.9	88.8	India	90.7	102.8	110.0
Taiwan	82.6	80.9	86.2	Indonesia	75.9	83.1	82.2
India	61.2	61.9	69.8	Sri Lanka	75.3	87.9	81.5
Indonesia	70.0	69.9	69.7	China	83.4	85.4	78.4
Thailand	54.1	61.8	60.8	Cambodia	62.7	75.0	77.6
Sri Lanka	64.9	68.8	59.8	Viet Nam	59.5	57.9	69.0
Cambodia	48.3	52.8	55.7	Bangladesh	58.6	60.8	67.9
Viet Nam	39.8	44.8	52.9	Pakistan	56.3	57.2	64.8
Bangladesh	50.6	48.5	46.0				
Pakistan	37.6	37.2	33.5				

Note: Average landed price per dozen.  
Source: World Trade Atlas.

The critical question to be addressed is why most competing Asian supply countries earned higher landed prices. The following reasons can be offered as explanations:

1. Because they are in permanent contact with the markets and with the buyers;
2. Because they are more interesting as suppliers as they are able to offer new products to buyers;
3. Because they offer more technically sophisticated and fashion intensive products – through their greater technical skills;

4. Because they control the raw materials supply;
5. Because they are able to deliver more quickly due to better integration of their production processes;
6. Because their production operations are geared to rapid import for re-export;
7. Because their administration mechanisms are streamlined;
8. Because of good infrastructure and transportation facilities; and.
9. Because of reputations built over the years.

Cambodia certainly fails on all points and these could be the main reasons for the lower realized landed prices.

Other issues to be considered in this context are:

- Garment shipments from Cambodia are targeting lower quality market segments than some of the other suppliers;
- As sales and marketing of Cambodian made garments is handled by offshore parent companies, the parent companies' strategies may be to channel basic, lower value products to be manufactured in Cambodia, whilst producing higher value products elsewhere;
- Garments with higher fashion content selling at higher prices are produced in countries where the materials supply is domestic and delivery lead times shorter; and
- Lastly, the quality of Cambodian garments may be consistently lower than garments from other Asian countries that command higher landed prices.

These demand-side competitive issues also need to be addressed as the Cambodian garment industry defines its own strategy, one that is not dependent on the strategies of offshore companies whose priorities are not the same. One of the main recommendations is to encourage local investors to become part of the industry in the same way that local investors have played a critical role in all competing countries. Also, to allow these local investors to develop the strengths of Cambodia as a textile and garment producing country and to convert present weaknesses into business opportunities in a way that foreign investors may lack the incentives to do so.

In today's dynamic world market conditions change daily and perhaps the change that will have the most significant negative impact on Cambodia's competitiveness is the ending of quota premium payments. These are presently paid by many of Cambodia's Asian competitors but not by Cambodian companies. When these quota premium payments cease at the end of this year the garment prices of competitors will be reduced, as discussed elsewhere in this report. For some China garment exports this can mean a price reduction of 34%. Cambodia will need to seek all means of enhancing the competitiveness of its garment industry to meet these challenges.

### **3.5. Technological Capability, Productivity, FDI and Industrial Deepening**

This section considers some selected key aspects of the Cambodian garment industry in more detail. The areas covered include technological levels and capabilities, productivity, role of foreign investment/domestic investment, and industrial deepening and backward linkage development.

### 3.5.1. Technological Levels and Capabilities

In the global marketplace, three levels of garment industry technology can be identified:

First, Level 3 Technology: fully automated operations wherever possible, advanced handling methods and equipment. Typical floor area required per operator is 12 square meters. This level of technology is typically found in the highest cost countries such as Germany and Italy, where the labor cost in the garment industry is in the range of US\$15 to US\$20 per hour, and where the garment industry is consequently becoming minimal except for unique, niche products at high prices.

Second, Level 2 Technology: automated features on sewing machines (for quality consistency), engineered work places (for smarter working) and designed handling methods (for efficiency of handling). Typical work area required per operator is 7 square meters. This level of technology is to be found, for example, in Mexico, Thailand and Turkey.

Third, Level 1 Technology: manual laying and cutting with basic sewing machines and without work aids (for quality consistency) or labor saving sewing features (for efficiency of handling). Typical floor area required per operator is < 4 square meters. The skills demanded of the workers are probably higher than for either level 2 or level 3 technologies. This level of technology is to be found, for example, in Cambodia, Bangladesh and Pakistan.

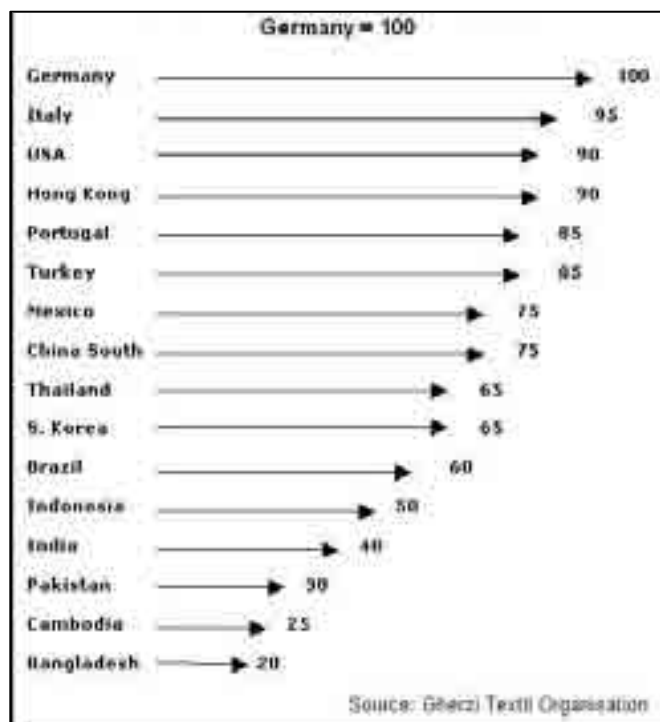
In general terms, based on the empirical survey, the levels of technology employed in Cambodia are at the lowest level in sewing and inspection. Few attachments are applied to the machines that could aid workers to operate more effectively, both in volume and quality terms. This is characteristic of countries where labor costs are very competitive as management consider it cheaper to employ people than to invest in machines or specific machine attachments. A few garment firms in Cambodia work with CAD systems and laying/cutting machines to minimize waste, but this type of technology is not widespread.

### 3.5.2. Productivity

In general terms, the levels of productivity reached in the industry are too low and similar to those in Bangladesh and Pakistan. This is due to a number of reasons including methods of skills development, culture/communication gaps between workers and expatriate production supervisors and other management, low motivation of workers, the large production (Chinese and Vietnamese style) halls in many companies, low levels of technology, lack of engineered work places, and high number of national and personal holidays.

Of the three levels of technology used in the garment industry, Level 1 Technology is predominantly used in Cambodia. Since the machines used are basic machines without attachments, the operators need to perform more actions than with automated machines, resulting in a higher work content. Additionally, because the

**Figure 3.6**  
**Labor Productivity in Woven Garments**



quality of the finished product depends more on the skill of the operator using Level 1 Technology, the probability of substandard work is greater and the need for re-working garments is higher. This becomes a vicious circle, as more inspectors are required to identify substandard work, etc.

The garment industry generally accepts that companies with Level 1 Technology must employ extra people rather than improve technologies used. The TA Project empirical survey of the Cambodian industry indicates that, even taking this into account, garment companies operating in Cambodia employ around 25-20% more people than is strictly necessary for companies operating Level 1 technology.

Accordingly, improvements of 40%-60% are possible in many garment companies, especially the larger ones<sup>20</sup>. It is often possible where labor costs are low to 'solve problems' by putting more and more workers on jobs to clear bottlenecks or other problems as the situations arise rather than to solve the cause of the problem. This only causes the original problem to escalate in terms of even lower productivity levels and higher costs. The situation may be compared with bottlenecks in the primary textile sector where management may choose to install additional machine capacities, often at high cost, that do not result in eradicating the problem but does add to cost and result in an imbalance of machine capacities. In the garment industry, part, or completed, garments are examined. Where faults are found, the seams have to be unpicked, re-worked, re-inspected, and included in the production line again. This takes time, requires additional personnel, and reduces productivity levels. The productivity issue is exacerbated by the number of holidays taken.

The highest productivity levels were found in smaller Cambodian companies where management teams train new recruits in accuracy and speed, as well as the quality standards expected of them, and encourage them to be successful. The level of motivation of employees was found to be much higher in these smaller units than in the large companies where employees were just numbers in departments employing many thousands of workers and were trained by being placed alongside 'experienced' workers.

Although the garment industry is the engine for growth in Cambodia, investment in systematic skills development of garment industry employees is not commensurate with its significance to the economy. Training of workers is, generally, informal. There is no systematic training for entry into the garment factories. Potential workers either pay a small fee to an outside tailor, usually US\$1 per day for 5 to 7 days training to learn to stitch in straight lines, or they receive on the job training after being recruited as trainees. In the case of the latter, a new recruit works alongside an experienced worker and will earn wages of about US\$1 per day, usually for a period of up to 3 months although this may be extended. The average earnings of an apprentice (trainee) are US\$25 -US\$30 per month for 48 hours work per week (208 hours per month).

In general, the low productivity of workers is considered to be one of the more easily tackled problems. Evidence from the ongoing ILO pilot project indicates that labor productivity could be increased by 10% to 29% through improved skills, better human resource practices, and better work ethics and organization. The ADB TA project will aim at strengthening labor productivity through a Pilot Project (see Annex 6) to strengthen skill development opportunities and improve human resource conditions.

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<sup>20</sup> This finding concurs with the results of the case studies carried out by ILO.

### **3.5.3. Role of Foreign Investment/Local Investment**

It is usual for foreign investors to join with local investors in setting up joint-venture companies, where the opportunities are (a) to use locally available material resources, (b) to sell into a strong domestic market or (c) to export the end product into identified target markets. In the case of Cambodia, there are no domestic investors with which to form joint-ventures and only the third option is available.

Most Cambodian-based garment companies (woven and knitted cut and sew as well as knitwear companies) are 100% foreign owned. This is an almost a unique situation in global terms. These foreign investors often have similar units in other garment assembly countries, e.g. Bangladesh, China, Indonesia, Pakistan, Sri Lanka and Viet Nam, and make all strategic business and sales decisions. Fabric/materials are distributed from their central headquarters to the units that will produce the garment orders. The decision as to in which of their manufacturing locations will make up garment orders is based on the manufacturing skills and costs of each of the units, the lead times available and especially the availability of quotas and preferential market access. After 1 January 2005, the question of quotas will no longer apply and production location decisions will be increasingly based on product quality, lead times, reliability in meeting delivery dates, productivity and cost competitiveness.

Cambodia's cost advantage will disappear when quotas end and quota premiums are no longer paid in several competing countries. Delivery lead times will necessarily be longer than in countries with domestic textile production; shipments of incoming materials can, and often are, subject to delays in shipment or at the port and so garment exporters may not be so reliable as units in countries that manufacture textiles. Costs will also be higher at a time when buyers are looking for faster deliveries for smaller orders at lower prices.

Discussions with buyers in other countries have indicated that major US and other buyers will focus on buying more from countries with integrated textile value chains. Possibly the value chain can extend back to fiber growing or production, but this is not an essential criteria. Garment companies in such countries are more likely to offer a superior service at lower costs than companies in Cambodia where all materials have to be imported indirectly (via Singapore), processed and exported indirectly (via Singapore).

In this context, where will the interests of the dominant foreign investors in the Cambodian garment industry lie? Will this be with their global business or to their manufacturing unit in Cambodia? The decision is not a difficult one, their global business is likely to be their choice. This is unfortunate because with few domestic investors to support the Cambodian garment industry, and most Cambodian based companies having no significant investment in the country, Cambodia is expected to lose a significant amount of garment business. If the garment companies in Cambodia had been joint-ventures, it could be expected that the local partners at least would an interest in consolidating the position of the garment industry by ensuring the prompt supply of the needed finished fabrics and other input materials. This could be achieved with backward linkages into textile production or strengthening commercial ties for supply capacities. Foreign investors do not see the same need or make the same commitments as would domestic investors.

### **3.5.4. Industrial Deepening and Backward Linkage Development**

The absence of significant backward linkages and domestic suppliers has been extensively discussed as a major negative feature of the Cambodian garment industry. This not only concerns yarn and fabric, but also most of the accessories and trimmings that are required. These include simple inputs such as threads, plastic collar inserts and clips, hang tags, etc., many of which require relatively small investments and which would be suitable for Cambodian investors. In addition, as already emphasized, it is clear from discussions with multi-national garment buyers that once quotas have ended they will look increasingly to

manufacturers having direct access to domestic suppliers of fabrics and trimmings for their garment shipments. This will enable orders to be supplied more quickly and at lower cost.

A recent report by the World Bank, 2003 considered issues of industrial deepening in three textile related value chains. The key findings of that research exercise provide context and substance to the subsequent discussion and are presented in Box 3.2. However, before considering the various options, it is worth highlighting three recent developments that deserve closer examination:

First, while it is interesting to note that 24 new garment factory investments were approved by the Cambodian Investment Board in 2003, with a total fixed asset value of almost US\$40 million<sup>21</sup>, demonstrating that there is still some interest in investing in the Cambodian garment industry, it is even more significant that a number of relatively large expansion projects (with five investments of over US\$3 million) were also approved (Table 3.24). Investments of this size imply that the companies are bringing in machinery that will be used to strengthen the value chain and carry out higher value-added activities such as spinning, weaving, knitting, or textile finishing.

<b>Company</b>	<b>Shareholdings</b>	<b>Fixed Assets (US\$)</b>	<b>Employment</b>	<b>Approval Date</b>
Cambo Fashion	Korea 100%	824,645	1,103	24/03/2003
Cinkamp Apparel	Taiwan 100%	859,706	633	16/09/2003
Eternity Apparel	China 100%	965,865	1,103	14/07/2003
Goldfame Enterprises Knitters	Not specified	21,000,000	3,537	15/01/2004
June Textiles	Malaysia 94%; Singapore 6%	3,286,630	1,633	8/8/2003
HS ENT	Taiwan 100%	1,950,000	1,246	21/04/2003
K&A Garment Factory	Cambodia 49%; UK 51%	334,605	503	3/7/2003
Oceanic Garment	China 45%; Hong Kong 55%	998,760	1,433	30/06/2003
Supreme Choice Garment	Hong Kong	416,500	94	12/8/2003
Top One Garment	Taiwan 100%	11,700,000	1,973	1/9/2003
USA Fully Field Garments	China 100%	399,900	500	17/07/2003
Winner Knitting Factory	Hong Kong	8,880,000	8,004	23/12/2003
Yung Wah Industrial	Taiwan 100%	8,734,660	234	15/08/2003
<b>Totals</b>		<b>60,351,271</b>	<b>21,996</b>	

Source: Cambodian Investment Board

Second, a US-owned company producing medical disposable garments, Manhattan Textiles and Garment Corporation (Manhattan), has invested heavily in the development of backward linkages to cotton farmers in Kompong Cham Province<sup>22</sup>. While facing all of the challenges outlined in the World Bank 2003 value chain report, the company has gone ahead and invested in the growing of cotton on around 500 hectare of land – providing the farmers with

<sup>21</sup> It is interesting to note that most of these investments involve fixed assets of just over US\$ 1 mn, presumably to meet the minimum investment requirements of the Cambodian Investment Board (see below). There is no data available on how much of the US\$ 40 million approved investments were actually realized.

<sup>22</sup> Based on firm interviews. See Cambodian Business, 2003 for more details.

seeds and buying back raw cotton. The company plans to expand the project to 3,000 hectare, which would provide their total fiber needs, assuming that the yield rate improves substantively. This would make the company less dependant on the international cotton market and less vulnerable to fluctuations in world prices of cotton. While this initiative is very interesting and has the potential to provide better livelihoods for a number of cotton farmers in rural areas, it should be noted that Manhattan produce a very special product that requires large quantities of simple, bleached (not dyed) fabric, thus making it possible to justify the investment made in developing domestic cotton production. Nevertheless, the possibility of finding other garment manufacturers that might benefit from the same type of deepening of the supply chain warrants further consideration.

Third, there was an announcement in July 2004 that a major Chinese textile group had signed a memorandum of understanding with the Royal Cambodian Government to develop an industrial zone in Sihanoukville and eventually set up an integrated factory with 500,000 spindles, along with weaving, printing, dyeing and garment processing. Scheduled to begin in 2004, the project would be by far the largest textile and garment operation in Cambodia, and also in Asia. Every effort should be made to ensure that this project proceeds in a manner that creates the maximum benefits and linkages to the existing industry, as well as to promote the development of Sihanoukville. Follow up interviews in late August 2004 indicated that the proposed project was facing problems in identifying Chinese investors willing to invest in Cambodia, largely due to the investment impediments outlined in this report.

With regard to policy related to backward linkage development, the World Bank, 2003 identified the absence of incentives and support for backward linkage development as a significant reason for the almost complete absence of support industries (Box 3.2).

In addition, several additional policy constraints exist to the development of backward linkages and the growth of an SME sector to supply the range of garment accessories that could be produced with relatively small capital investments<sup>23</sup>. First, in order to obtain the import duty exemption that would be necessary in order to compete with the ability of garment manufacturers to import accessories duty-free, Cambodian SMEs would require investment approval from the Council for the Development of Cambodia (CDC). The CDC requires a minimum investment of US\$500,000 or US\$1 million depending on the type of activity<sup>24</sup>. This minimum investment level is very high, compared to Thailand for example, and acts as a strong deterrent for almost all SME investors hoping to supply accessories to the garment industry. It is understood that the CDC is presently preparing a sub-decree that will define the specific investment promotion conditions under the newly enacted Law on Investment. The CDC is urged to reconsider these very high minimum investment levels.

Second, as with all transactions in the domestic market, sub-contracting is now subject to a VAT tax burden of 10%, despite the fact that the same imported inputs are imported duty and tax free and the final export product is tax exempt. While VAT can eventually be refunded, industry sources report that this takes a long time and that it is rarely possible to refund the full 10%. Again, this tax burden tends to discourage Cambodian SMEs from entering the garment manufacturing sector and, ultimately, the lack of a dynamic and vibrant SME business sector will discourage foreign investors from new investment in Cambodia.

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<sup>23</sup> These policy constraints have been identified and stressed by the private sector through the submission of a proposed agenda for the meeting of the Export Promotion Working Group under the Private Sector Forum in early 2004.

<sup>24</sup> See Cambodian Investment Board (undated). Laws and Regulations on Investment in the Kingdom of Cambodia.

### Box 3.2: The World Bank's Value Chain Analysis

The World Bank supported the preparation of a pioneering study on Cambodian value chains. Three of these are of relevance to the present study – cotton growing, textile manufacture, and garment manufacture. The salient points for each value chain are outlined below.

#### Cotton Growing

- Cotton farming in Cambodia is presently rather limited and carried out by largely illiterate farmers. Cambodia lacks a systematic structure and organization for the marketing of cotton.
- Seeds account for 41% of the total cost and all high-quality seeds must be imported. In practice these seeds yield much lower harvests (1.2 tons per hectare) than similar seeds in China (2.5 tons per hectare).
- Most cotton farmers do not have the financial resources to irrigate their farms or to purchase adequate fertilizer inputs, the second major cost element of the value chain. These constraints also result in lower yields.
- Most harvesting is done manually as farmers cannot afford machines and labor, although inexpensive, is estimated to be only 50% as productive as in China.
- As in all sectors, transactions costs and other unofficial payments result in higher costs for imports (of seeds and fertilizers) and problems with exports.

#### Textile Manufacture

- The textile industry in Cambodia is very small and in an early stage of development. Apart from Manhattan, there is some yarn dyeing and some flat bed knitting.
- The textile industry utilizes imported raw materials such as cotton, yarn, and chemicals, and these materials account for 65% of the total cost of the value chain.
- The use of local cotton would significantly reduce the production cost of yarn, even at the present low domestic yield rates<sup>25</sup>.
- The cost of electricity is a major factor, and the high cost of imported fuel oil is a serious problem. This also raises transport costs.
- The available labor has low-level skills and there exists no institutional framework to provide technical training support to the textile industry.
- The high costs of importing/exporting create serious problems in the textile value chain.

#### Garment Manufacture

- Sustained growth of the value chain is determined largely by preferential market access to the major markets, making this a quota-dependent industry. It is not clear how capable the garment industry is of entering new non-quota markets.
- The garment industry faces strong dependence on high-cost, imported raw materials, partly due to high administrative costs.
- Garment factories face unnecessary factory inspections, high export charges, and cumbersome export procedures.
- A large percentage of exports are dependent on foreign companies with no vertical linkages.
- Lack of incentives and support for backward linkages to deepen the supply chain.
- High costs of electricity and diesel fuel.

Source: World Bank, 2003

The TA project team believes that, even considering the three developments outlined previously, there remains a strong need for Cambodia to respond more proactively to the challenges of developing the backward linkages required to meet the demands of global garment buyers and rules of origin requirements of major markets.

A number of options are available:

First, the promotion of investments in selected backward linkages accompanied by removal of all significant policy impediments. The TA project team does not recommend that Cambodia invest in cotton growing or in man-made fiber (MMF) production. (The Manhattan cotton project is a special case and will be a long-term, albeit innovative and interesting, project.) Investment in cotton spinning or even in weaving is not proposed as a priority. The

<sup>25</sup> However, detailed feasibility studies need to be prepared for woven fabric production and knitted fabric production.

most practical investments would be in circular knitting units with knitted fabric processing that are linked with garment cut and sew units. Balanced units of about 5 tons a day capacity are economically sized, based on 24-hour production. Suitable overtime rates and power costs need to be established at the outset and new or re-located used plant could be installed. Promotion of investment in a woven fabric process house, possibly working on a commission basis, could also be considered to convert imported woven gray fabric into finished fabric of the needed colors and quantities. Again, new or used plant could be considered. The grey woven fabric, in selected 6 or 8 standard and popularly used constructions, would be held in stock for immediate processing. It would be interesting to explore collaboration with some of the major expansion projects mentioned earlier – seeking to leverage these investments to generate additional interest and cross-company exchanges of inputs and perhaps services.

Second, allow the establishment of “common bonded warehouses” (CBWs) in Cambodia or in neighboring countries. Before considering CBWs, it is worth noting that “factory bonded warehouses” have also been recommended by GMAC as a possible mechanism in the short-term to reduce the number of steps in the import/export process and cut down on the unofficial transactions costs that plague the garment industry. This option has been successfully used in Malaysia<sup>26</sup> where many factories have a full-time customs officer (paid by the Malaysian Customs Authority) stationed at the factory and have put in place the fencing and other infrastructure and accounting procedures to function as a bonded warehouse. In addition to providing an efficient import-export procedure, each factory is given a reference number so that purchases from local suppliers and subcontractors are exempted from sales and other taxes, as the materials purchased will be used in exports.

The domestic option of the common bonded warehouse is possible under the new Customs Act that expected to be passed as a priority by the new government. However, the difficulty with common bonded warehouse systems in general is in forecasting accurately the quantities of particular woven and knitted fabric constructions and the specific colors required. If the color range is restricted to standard shades, this will restrict manufacturers to non-fashion items. Trimmings will also create similar constraints. See Box 3.3 for a description of common bonded warehouses.

Third, the establishment of Export Processing Zones in Phnom Penh and Sihanoukville, along the borders with Thailand (where a number of projects are under discussion), and along the border with Viet Nam (where one significant project is being developed). An important issue that must be carefully considered when planning and building these zones concerns environmental protection and the provision of the wastewater and related treatment facilities required by various parts of the garment and textile value chain.

Whichever approach is taken, there is no doubt that Cambodia needs to actively attract new or expansion investments in the garment industry and related backward linkage areas to support existing garment manufacturers.

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<sup>26</sup>

Based on email correspondence with a Malaysian garment manufacturer.

### Box 3.3: Common Bonded Warehouses

Common bonded warehouses (CBWs) are similar in practice to Export Processing Zones (EPZs) except that, instead of encompassing a complete industrial estate with many companies, they perform a similar function for individual companies. In general terms, CBWs work well as companies are able to import raw materials and export finished products with the minimum of bureaucratic interference, without excessive customs involvement, and with the opportunity to stock materials, perhaps at suppliers' cost, until they are required for manufacturing. Further, as in many EPZs, the laws of the host country may not apply.

CBWs work well when the materials to be stocked are standard items that run continuously without change and in constant amounts month after month through the year. For example, for a woven fabric dye house that consumes a limited number of different fabrics (say, 5 or 6) throughout the year, forward orders can be placed for gray fabrics with the confidence that if one fabric has less demand this month, it will be consumed the following month. A further example would be the case of a shirt manufacturer producing shirts using polyester/cotton blend fabrics in 6 classical colors, where the off-take varies only slightly throughout the year. Here, also, stocks of dyed and finished fabrics can be held with the confidence that if the assortment of colors varied over a few months, the fabric orders placed can compensate for the changes within a short period and excessive stocks are not carried.

The advantage of CBWs is lost, and becomes a financial liability, when the combination of fabric constructions/color combinations cannot be predicted with accuracy, e.g., in the garment fashion industry. Fashion is unpredictable in many ways and colors that are required in the markets today may not be required tomorrow. Further, garment buyers demand that a color assortment range be delivered completely. It is of no value to retailers if 9 colors out of 10 are available and the remaining color will follow a month later, or if 80% of the quantity in color "X" is available now and the balance will follow later.

CBWs have to face the problem of which markets to serve with what products and at what cost. The result could probably be very restrictive in business terms and could be extremely costly:

- Low risk/limited cost, standard products with regular monthly quantity use, e.g. woven or knitted gray fabrics, standard dyed and finished fabrics in a limited classical color range. Stocks held in bonded warehouses can reduce lead times
- High risk/high cost- fashion fabrics where the variety of fabrics used is high and the quantity used is unpredictable. Stocks in CBWs cannot reduce lead times.

## 3.6. Market Access and Regional Issues

The importance of preferential trading arrangements and the potential for improving these was highlighted in detail in Chapter 2.3. It is increasingly evident that concerted efforts by Cambodia to negotiate improved preferential access schemes can play an important role in increasing the competitiveness of garment exports, at least in the short-to-medium term. While not addressing the basic weaknesses of the industry, better market access could provide a period during which the government and private sectors together could take steps to strengthen the garment industry. Meanwhile, greater regional cooperation could also play an important role in strengthening the fundamental competitiveness of the industry, particularly in terms of lead times, but also in terms of meeting the cumulation requirements of preferential access schemes.

### 3.6.1. Market Access Arrangements

In general, the "negotiating" approach of Cambodia to each of the three major markets – the US, EU, and Canada – could build on the recommendations for improvements discussed in Chapter 2.3.

**The United States.** Clothing exports to the US from Cambodia are not covered by the US GSP scheme and therefore pay import duties of around 17%. However, these exports would be covered if Cambodia could benefit from preferential market access and rules of origin

under terms similar to the AGOA scheme geared towards Sub-Saharan African countries. Indeed, recognizing the potential for competitiveness of GSP duty-free access (around 17%), GMAC, jointly with the Cambodian Ministry of Commerce, has employed a lobbyist in the US to push for such preferential access, or at least much more favorable access. In addition, the potential for safeguard measures to limit China's imports into the US market for up to four years is also significant<sup>27</sup>. In both these efforts, the substantive measures taken by the Royal Cambodian Government to ensure compliance with ILO labor conventions should be an advantage.

**The European Union.** In the EU, data suggest that a very small share of Cambodia's exports benefit from GSP duty-free access (see UNCTAD, 2003). The reasons usually cited for the inability of Cambodian exports to access the EU GSP scheme is inability to meet the rules of origin. In addition the derogation scheme designed to address this problem largely failed due to the non-inclusion of China in the derogation list. A joint public-private sector approach from Cambodia to the EU should focus, therefore, on (a) broadening the derogation on rules of origin to include China, and (b) changing the value-added calculations in the rules of origin to allow the Cambodian garment industry to use higher quality and cost fabrics and target niche markets.

It should be noted that this potential for duty free access to the EU marketplace, in addition to the reduction of lead times, provides a powerful argument for strengthening backward linkages and increased local value-added.

**Canada.** Although Canada has grown quickly as a market for Cambodian exports since the inclusion of garments in the Canadian GSP scheme in early 2003, the Canadian market remains small and should not be given priority over efforts to improve market access to the US and EU. Nevertheless, there is still room to lobby for relaxation of the manufacturing stage requirements of this GSP scheme.

### 3.6.2 ASEAN Cooperation and Cumulation Schemes

Regional cooperation can be a viable approach to sustained economic growth and companies must explore all opportunities to join regional and global supply chains. Through regionalization, garment industries have better prospects to maintain business volume, lower overall production costs and add more value to products. A regional strategy can also promote intra-regional trade on the basis of preferential access and attract foreign investment. In a recent speech (Cham Prasidh, 2004), the Cambodian Minister of Commerce posed a challenge to the Cambodian business community and related government agencies to consider the recommendations put forward by the ASEAN Federation of Textile Industries (Box 3.4).

Cambodia has for some time been considering the establishment of industrial zones close to the border with Thailand in order to attract investments from companies in Thailand that have lost preferential market access or competitiveness due to increasing labor and other production costs.. Van, 2003, points out that the ASEAN coordinating forum for textile and clothing recently endorsed the concept of moving garment factories to new ASEAN member countries (Box 3.4). Such companies could either locate new assembly facilities in Cambodian industrial parks or enter into outward processing arrangements with companies in Cambodia. In a similar manner, Vietnamese companies that cannot benefit from the liberalized markets since Viet Nam is not yet a member of WTO, might also relocate facilities to Cambodia. Supplying cheaper electricity from Viet Nam to run the factories is also being considered.<sup>28</sup>

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<sup>27</sup> This point is highlighted in Mekong Capital, 2003.

<sup>28</sup> Based on interviews with industry representatives.

<b>Box 3.4: Recommendations of AFTEX</b>
Drop non-tariff barriers urgently for the textiles sector, at the latest by 1/1/2005 to enable smoother intra-ASEAN flow of goods.
In view of their more advanced status, 5 of ASEAN's original members should shift to original design manufacturer (ODM) mode leaving other members – Cambodia, Lao PDR, Myanmar, Viet Nam, and possibly Indonesia – as ASEAN garment manufacturers.
Promote a joint stand on sourcing by ASEAN in major international garment forums and aim to attract decision-making buyers.
Negotiate with the EU and US to accept ASEAN cumulative rules of origin for textile and apparel products, especially for CLMV countries, and also for more flexibility on transfer of quotas before the expiry of the quota system.
The private sector to coordinate outsourcing activities among ASEAN companies by establishing regional distribution centers to reduce turnaround time and raw material costs.
ASEAN companies to cooperate and become original design manufacturers and promote own brands.
Consider the inclusion of textiles and garments in the ASEAN Integrated System of Preferences.
CLMV(I) countries should grant preferential tax incentives to textile and garment companies from more advanced ASEAN countries in order to keep such investments within ASEAN rather than going to China or other non-ASEAN locations.
Source: Extracted from Cham Prasidh, 2004.

In both of these cases, the support of the Royal Cambodian Government will be critical to remove all the investment and operational impediments that might discourage such activities. In fact, EPZs have proposed in Cambodia for many years, with very little progress.

Another possibility is to seek ways of taking advantage of ASEAN cumulation. However, as previously mentioned, the most cost-effective source of fabric for most companies is China, and China is not yet covered by any cumulation scheme<sup>29</sup>. In addition, experience both in Cambodia and elsewhere has shown that whilst such arrangements seem to be the solution to many supply problems, in practice the situation is rather different. This is especially the case when the trade and transportation crosses borders and customs clearance and import/export documentation is required. Cumulation procedures in most preferential trade agreements also appear to be complex and limited in coverage. In many cases, garment manufacturers perceive that such arrangements may work much more to the benefit of the companies/countries that supply the fabrics or yarns.

In conclusion, while the Cambodian garment industry and the public sector must be aware of the potential for regional cooperation and be proactive in seeking new opportunities to strengthen value chains, identify new suppliers, and encourage new investors, it is unlikely that this can substitute for investing in domestic suppliers and backward linkages.

<sup>29</sup> Recently, there has been much talk of the ASEAN-China Free Trade Agreement, but it is not clear that this will benefit the Cambodian garment industry unless it involves the inclusion of China in the rules of origin of EU, US or Canadian preferential market access schemes. Garment industry inputs from China already enter Cambodia duty-free, so there will be no cost advantage from a free trade agreement.

## **4. The Backbone of the Industry: Garment Employees**

A workforce of over 230,000 persons, earning an estimated US\$135 million in wages, forms the backbone of the garment industry in Cambodia. A further number of workers are employed in small- and medium-sized companies that act mostly as sub-contractors. These employees are generally more vulnerable with regard to employment security, payment of minimum wages and decent working conditions. There is also a wide range of informal businesses, largely managed by women, that have sprung up around factories to provide support services to garment industry employees, such as food, beauty parlors, child care, etc. The size and extent of these operations is not known precisely<sup>30</sup>.

Overall, these employees are generally in a vulnerable position with regard to secure employment, payment of minimum wages and decent working conditions, and some feel that the garment workers do not receive a fair share of the garment industry profits. In 2004, it is estimated that 85% of the garment industry workforce is female, and the industry absorbs nearly 20% of the female labor force aged 18-25 years. Young women migrate to urban areas in order to provide cash income for their families remaining behind in rural villages. Rural poverty continues to be a major concern, as the small farm holdings in the workers' home villages can no longer sustain the large families. The ongoing migration has resulted in an increase in the incidence of urban poverty.

In addition, an estimated 250,000 young people join the labor force in Cambodia every year, so the need to generate new jobs is very high. Outside of the textile/garment industries there are presently few opportunities, particularly for women, except in the tourism sector. When women migrate, their traditional ties with communities are weakened and they forego support such as childcare, neighborhood security, and access to credit from family/community members in times of need. Many of them feel alienated in urban areas and often face social stigma. Garment workers are not considered "good for marriage."<sup>31</sup>

### **4.1. Labor Market Issues**

#### **4.1.1. Availability of Labor**

The increase in paid employment in Cambodia can be attributed largely to the garment sector. According to the Labor Force Survey (LFS) of November 2001, labor force participation rates for individuals aged 10 years and above peaked at 94.6% for the 35-39-years age group. This then gradually declined from the 40-44 years age group (94.4%) until it reached the age group of 65 years and over (39.0%). For women, the participation rate was highest at 91.2% for the 45-49 years age group, after which it declined until it reached the 65 years and older age group at 27.8%. The female labor force participation in the urban and Phnom Penh areas for all ages exceeded that of males. Notably the participation rate for the 10-19 years age group was higher for women in both rural and urban areas. The female labor force was dominant in the manufacturing and wholesale, and retail business sectors.

The prevailing social standards and traditional attitudes towards the education of girls and ideas regarding "appropriate" employment have often placed women in an inequitable position in the labor market. The overall gender outlook on the labor market is summarized in Table 4.1.

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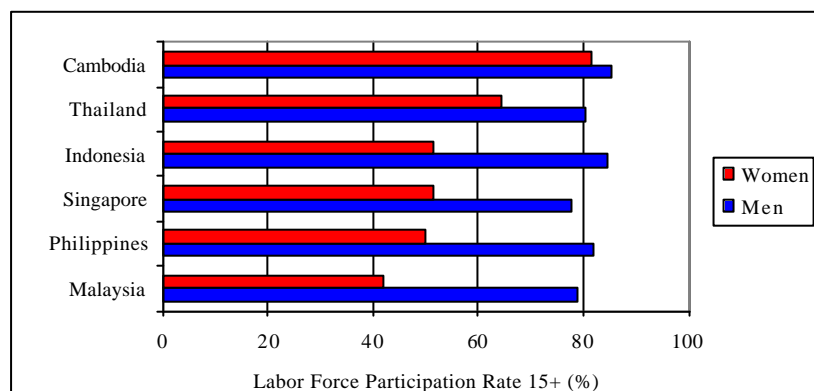
<sup>30</sup> It is proposed to examine this phenomenon in Phase II of the Socio-Economic Survey of Garment Employees in Cambodia (SESGEC) from September-December 2004.

<sup>31</sup> See Oxfam, Womyn's Agenda for Change, 2002.

Indicators	Value (%)
Women's share of the economically active population	52
Total labor force participation rate of women aged 15 years and older	82
Labor force participation rate of women/men aged 15-19 years old	72/62
Percentage of women/men in formal employment	14/19
Women's share of total formal employment	43
Women's share of formal employment in agriculture	51
Women's share of formal employment in garment industry	84
Women's share of formal employment in other industries	31
Women's share of formal employment in public service sector	22
Women's share of formal employment in other service	29
Share of the garment industry in growth of the industrial sector	94
Difference between men's and women's wages	33
Sources: Census, 1998; National Institute of Statistics, 2001; Beresford et al. 2003; Godfrey et al. 2001.	

Cambodia has the highest female labor force-participation rate in the region at 82%, compared to 64% in Thailand and 52% in Indonesia (Figure 4.1). These rates have been increasing since the early 1990s. Among the population aged 10 years or older, the percentage of women in the labor force increased from 55% in 1993/1994 to 71% in 2001. Over the same period, the percentage of men in the labor force increased from 58% to 72%. Labor force statistics also show that participation rates are higher in rural areas than in urban areas, particularly for women.

**Figure 4.1: Regional Labor Force Participation Rates**



Source: CDRI, 2001.

The labor force survey estimates of the labor profile of the garment sector in Cambodia are presented in Table 4.2. It is clearly indicated that, as previously noted, there are no domestic factory owners in the garment sector.

Item	Total	Male	Female
Total Employees	253,489	41,378	212,111
Employers	0	0	0
Own Account Worker	42,844	8,164	34,677
Employees	200,011	32,028	167,983
Unpaid Family Worker	9,686	1,182	8,504
Others	947	-	-
Source: National Institute of Statistics, 2001.			

The ADB Participatory Poverty Assessment (PPA) gathered qualitative data on the gender differences in the formal employment market. PPA focal group participants felt that the opportunities for paid employment for poor people in general, particularly poor women, were very limited. Traditionally, young men are encouraged to find paid work, which usually requires migration, while women are discouraged. Opportunities for young women to work in garment factories have however overcome these ideas. PPA participants recognized the growing opportunities for paid employment due to the garment industry, however, many participants felt that, ultimately, young garment workers would be better off if they remained in their villages. This was attributed to a fear that if young girls move to urban areas they will be led astray and will lose their virginity before “properly” marrying.

Country	Operator Hours Per Year	Average Cost Per hour (US\$)	Overtime Pay (%)	National/ Religious Holidays (%)	Shift Premium	
					Second Shift	Night Shift
Cambodia	2,304	0.23	50	100	0	100
China	2,205	0.69	50	200	20	20
India	2,350	0.58	50	33	17	20
Indonesia	2,080	0.32	100	100	0	10
Malaysia	2,176	1.13	25	39	50	50
Pakistan	2,416	0.37	35	70	20	20
Sri Lanka	2,322	0.46	25	50	0	25
Thailand	2,380	1.18	150	200	1	2

Note: Cambodian Labor law only allows for 2 hours overtime per day  
Source: Werner International Management Consultants (Spinning and Weaving Labor Cost Comparisons), presented in Van, 2003.

As shown in Table 4.3, operator hours per year were highest in Pakistan at 2,416 hours compared to 2,304 hours in Cambodia. Per hour operator costs were, however, lowest in Cambodia, although the night shift premium in Cambodia was by far the highest of all countries.

#### **4.1.2. The Labor Law and the Garment Industry**

The timely and transparent implementation of labor laws, that provide adequate protection against exploitation, is a particular concern from the perspective of garment industry employees. The work force, largely female, is disciplined but insecure and often not adequately trained or motivated. Further, the standards of the factory working environment and facilities for sanitation and health vary between factories. The combined effect is a reported high turnover of staff (up to 40% per year in some factories, according to anecdotal evidence). This can be detrimental both to the garment industry as well as to the employees and the families they support.

The ratification of the major ILO conventions relating to women and equality by the Royal Cambodian Government in 1997 resulted in an amended Labor Code that requires special and adequate working conditions and treatment for female workers. This is highly relevant from the perspective of the largely female workforce of the garment industry.

There are seven primary areas of the Labor Law of interest from the employee and gender perspectives. These are:

**a. Wages, Overtime and Annual Leave (Labor Article 102-119)**

Any agreement that would pay a worker at a rate less than the minimum wage shall be void. The minimum wage for the garment industry is US\$45 per month for regular (permanent) workers, with entitlement to an attendance bonus of US\$5 per month for regular attendance. The overtime rate is 1.5 times the basic rate, whilst the rate for work on Sundays and national holidays is 2 times the basic rate. The normal working week is 6 days, each of 8 hours, with a maximum of 2 hours overtime per day and a total of 30 hours overtime per month.

Workers are entitled to a meal allowance of US\$0.25 cents in lieu of a meal, when working overtime. All workers are entitled to paid annual leave of 18 days from the first day of employment.

**b. Gender discrimination (Constitution Article 36, and Labor Article 12)**

Both men and women are constitutionally guaranteed the right to freely choose their type of employment. The Labor Code provides that women should not be discriminated against in hiring.

**c. Sexual Harassment (Labor Article 172)**

All forms of sexual harassment are forbidden.

**d. Pregnancy and Maternity Leave (Labor Article 182, 1183)**

Women workers are entitled to unpaid maternity leave of 90 days. Women with uninterrupted service of a minimum of one year are entitled to maternity leave at half of their regular wage. Employers are prohibited from dismissing women during their maternity leave.

**e. Breast Feeding and Nursing Room/Day Care (Labor Article 184, 186)**

Starting from the birth date of the baby, mothers are entitled to one hour per day to breast feed the child during working hours. Companies employing 100 women or more shall set up a nursing room/day care room within their factories. Employer unable to provide this facility, for whatever reason, must pay for women employees' childcare costs.

**f. Right to Form Unions (Labor Article 266, 2667, 280, and Constitutional Article 36)**

Workers have the absolute right to form unions to promote their interests and to protect their rights. Acts of interference with this right are forbidden.

**g. Safe and Sanitary Working Conditions (Labor Article 229, 230)**

All factories must maintain working conditions essential for the health and safety of the workers.

## 4.2 Working Conditions

While there exists much anecdotal evidence on working conditions in the garment sector, the only real information that can be obtained from statistical data, namely the Labor Force Survey of Cambodia, November 2001, concerns average working hours in the garment sector. The overall average is 56 hours per week.

	<b>Number of Workers</b>	<b>Average Number of Hours Worked.</b>
<b>Total Average</b>	253,489	56
<b>1-14 hours</b>	2010	12
<b>15-29 Hours</b>	5154	22
<b>30-44 Hours</b>	11,699	37
<b>45-49 Hours</b>	41,714	48
<b>50-54 Hours</b>	19,641	52
<b>55-59 Hours</b>	84,372	56
<b>60 Hours and over</b>	88,898	64

Source: National Institute of Statistics Labor Force Survey, 2001

NGOs working with garment industry workers report that practice of the above labor laws is not perfect or adequately enforced by government authorities. Several of the Labor Codes do not have penalties attached, making these legal protections virtually ineffective. The ADB TA project company-level survey and SESGEC both confirm this finding, particularly on issues of overtime, maternity benefits, meal allowances, annual leave, sanitation facilities, and facilities for breast-feeding and child care. Anecdotal evidence showed that an employee who had been working for four years in a factory was provided a maternity allowance of US\$68 by the factory and US\$12.5 by the trade union when she had her first child. Her salary at this time was almost US\$60 a month.

## 4.3 Socio-Economic Survey of Garment Workers of Cambodia

To gather more precise information on the situation of garment industry employees, a comprehensive socio-economic survey was commissioned during Phase I of the TA project. Carried out by the Cambodian Researchers for Development (CRD), the survey was completed in early February 2004 by a team of trained investigators and was supervised by an organizational management expert.

**Significance and Limitations of the Survey.** This is one of the first of such surveys to be conducted on this scale in the private sector. Although there were difficulties in conducting the survey, the desired coverage was achieved in that data was gathered from 1,538 employees from 10 representative garment factories. The single largest constraint was access to the garment factories. Only three factories allowed access during working hours. The remaining respondents were interviewed at various locations where garment industry workers live in large groups. Employees were frequently frightened to share information related to the garment factories, trade unions, and other information.

### 4.3.1 Objectives and Methodology

The survey was designed to establish a profile of typical garment sector employees with regard to education and skill levels, family socio-economic background, job search, recruitment, and retrenchment, as well as future employment and personal aspirations. Additionally, an attempt was made to better understand human resource practices, physical

environment, and working conditions within the factories as these affect employee personal conditions as well as their productivity levels.

The survey considered a representative sample of 15,000 garment industry employees drawn from 10 selected factories that were representative of the garment sector as a whole in terms of size (number of employees), location and type of operation. A combination of qualitative (focus group discussions and structured interviews) and quantitative (survey questionnaire) methods of data collection were used to gain different perspectives, and to cross-validate findings in the survey.

### 4.3.2 Garment Worker Characteristics

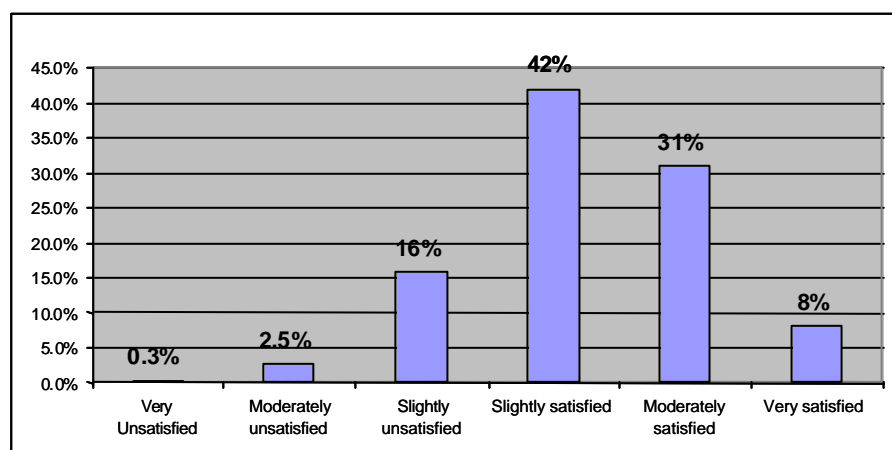
Overall, it was found that garment industry employees are mainly women (90%)<sup>32</sup> who usually migrate from rural areas and are driven primarily by economic necessity. The Labor Force Survey of 2001 puts this at 85%, while data in the gender assessment of A Fair Share For Women (MOWVA, 2004), confirms the survey findings of 90%.

More specifically:

- Typically, women garment industry employees come from large families and their households frequently suffer from droughts and floods, severely impacting their family's rice-farming livelihood.
- Most (over 50%) have a partial elementary education, and 74% were under 25 years old. These women come to work in the garment factories because they see no other economic or livelihood opportunities open to them. Most garment industry employees have no education or do not complete primary school and only a small percentage have access to secondary school and above. The CDRI survey of 2000 confirms that the average educational level of young, female garment industry workers is low. Of those surveyed, 61% had attended only primary school, 31% had attended middle school, and only 8% had a high school education.
- Skill levels are initially low but, either through experience or training, garment industry workers gain the skills required for employment. The largely young, female workforce is viewed as being disciplined.
- Once an employee secures a position, on average they stay in that position in the same factory for several years. Garment industry workers demonstrate little job mobility, although some have moved up to line-management positions, and a small percentage has changed factories.

Some of the major reasons for leaving a factory are poor health of the worker, in search of higher wages, or a factory slows or closes down production. Overall the majority of garment industry employees surveyed were slightly satisfied or moderately satisfied with their current employment.

**Figure 4.2: Satisfaction Levels of Garment Workers**



Source: ADB, 2004 (SESGEC).

<sup>32</sup>

This is corroborated by the global data on garment employees as well as other studies conducted on a more modest scale by NGOs.

- Often young men and women migrate in groups and have relatives and neighbors from the same village employed in garment factories. The main reason for migrating to the city for work is insufficient food, in spite of the family owning land and other assets. Research indicates that this is because a significant percentage of Cambodia farmers, who previously had a reasonably secure life, are moving towards insecurity due to a number of factors that have made agricultural production uncertain from year to year.

### 4.3.3 Health and Safety Issues

Health and safety factors are of grave concern to garment industry employees. Many feel that they are damaging their health working in a garment factory, and are getting weaker daily. Many workers state that they are breathing in cloth dust without adequate protection and suffer from water-borne illnesses, both of which severely affect their health. Medicine costs are a major expenditure for many employees. Other significant expenditures are basic living costs, and sending money home to their parents. Monthly income, including overtime pay, is in the US\$50 to US\$75 range for most of the respondents. The cost of basic living is usually between US\$20 and US\$40 while, depending on income for the month, remittances to family will be between US\$10 and US\$30.

Employees pay as little as possible on supporting themselves (food, housing, and utilities), so that they can remit more money to their home villages to support their families. This practice also contributes to the generally low level of health. Currently, health care facilities in the garment industry are not only minimal but are generally geared to deal with accidents and fatigue on the job rather than overall well being. The few donor-supported programs in a very few industries (e.g. CARE International, ILO) tend to focus on issues of occupational health and health education, particularly on HIV/AIDS prevention.

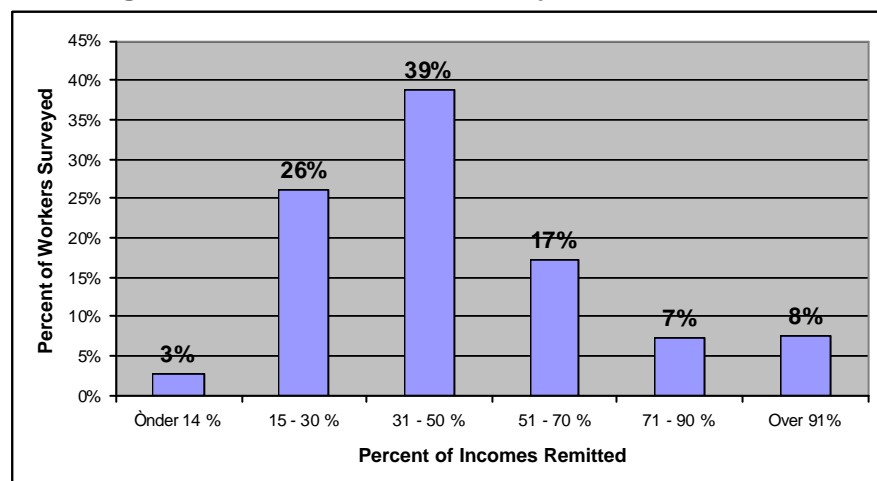
### 4.3.4 Income Remittances

Dependence on remittances from garment industry employees has transformed the social fabric of rural communities. The money provided to the families of garment industry

employees allows a better standard of living (having enough to eat regularly), allows for repairs to the family home (especially roofs), and most significantly provides educational opportunities for younger siblings. The remittances of the garment industry employees are significant components in the rural livelihood strategies of many families, helping some families to avoid the

worst ravages of poverty. The results of the survey on remittances are shown in Figure 4.3. Almost 90% of the respondents remitted money to their families. Of the remaining 10%, several had their families living with them and for that reason did not send money home. Remittance obligations were strong and the amounts remitted were a significant part of workers' salaries, ranging from around US\$20 to US\$40.

**Figure 4.3: Remittances Made by Garment Workers**



Source: ADB, 2004 (SESGEC).

Some NGOs working in the garment sector hold the converse view that the growth of the garment industry has transformed rural communities in negative ways. These NGOs document that many families have lost their traditional livelihoods and sometimes lost land by selling it to support a female member of the family who is working in the garment industry during periods of unemployment<sup>33</sup>.

#### **4.3.5 Human Resource Practices and Management Issues**

The total salary received by garment industry employees varies considerably depending on a number of factors, particularly job status – permanent, trainee or temporary - and the amount of overtime worked.

In terms of recruitment practices, while the SESGEC did not reveal consistent evidence of payment to gain employment, this was suggested in many interviews. According to the results of a CDRI survey, about 50% of garment industry workers paid an average of US\$38 (about one month's wages), to obtain jobs in the garment industry. This "fee" is paid to a number of people, i.e. factory security guards, interpreters, labor brokers, etc. (MacLean, 1999 ). This is an important management practice with regard to the issue of skills upgrading since, if it is necessary in any case to "buy" a job, the benefit to a job-seeker of developing greater skills is clearly lower than if jobs are allocated to applicants with greater skills.

Cultural gaps with management were also a cause for concern, and it was noted in many surveys that most garment factories in Cambodia do not have specialist human resource managers. This is a major concern when increasing productivity in garment factories becomes important and calls for the injection of improved human resource management practices into the garment companies.

With respect to unions, although workers' unions have extensively developed in the garment sector, these tend to have political affiliations and are often pursuing their own agendas. No attempts have been made to initiate any association or organization using a gender approach, which is surprising considering that 85-90% of garment industry workers are female.

In general, there appeared to be limited awareness of the labor laws, and garment industry employees are more attuned to factory rules. However, the SESGEC did show that there appears to be significant awareness of Cambodia's accession to the WTO. This corroborates evidence presented by the Economic Institute of Cambodia, 2003, which found that about 50% of garment industry employees had heard of WTO, and a large majority felt that WTO membership could be helpful.

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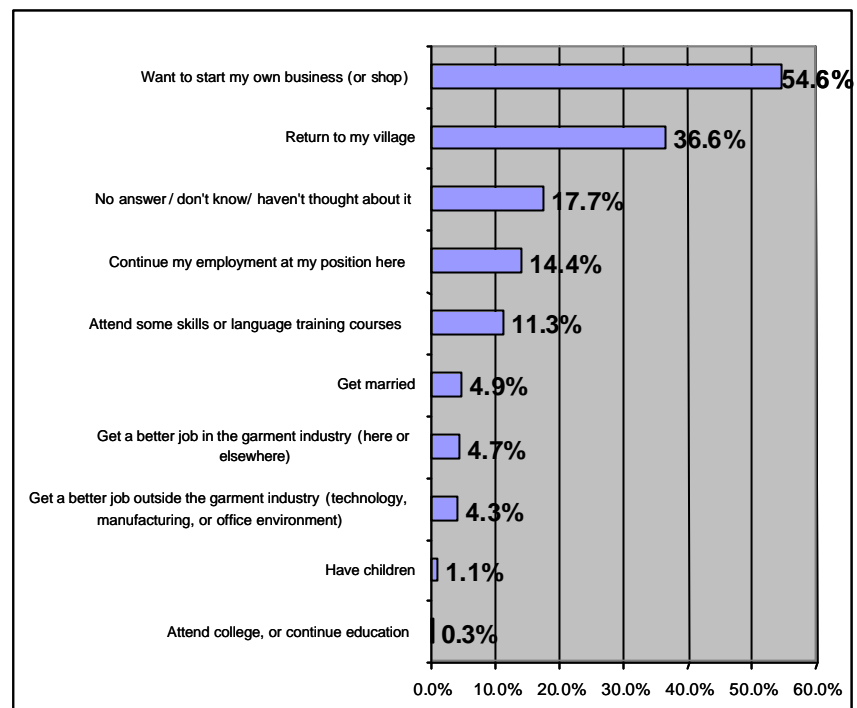
33

Such issues will be explored further as part of the Phase II of the SESGEC.

### 4.3.6 Future Aspirations

In the short-term, employees generally expressed a willingness to continue to work in a garment factory as long as the factory had work. However, while employment in the garment sector was an immediate economic need, it was not the long-term choice of over 50% of the garment industry employees surveyed. In the longer-term, it was interesting to note that more than 50% of garment industry employees indicated that they wished to start their own business, and around one-third wished to return home. Based on this finding, the Garment Employee Development Pilot Project offers opportunities to set up small businesses to garment industry employees through Self Help Groups (SHGs) programs to be implemented by the NGO PADEK. For details see Annex 6.

**Figure 4.4: Garment Workers – Future Plans and Goals**



Note: Respondents were free to list all plans and goals that came to their minds for a 3-5 year time horizon.  
 Source: ADB, 2004 (SESGEC).

### 4.4 ILO Garment Sector Working Conditions Improvement Project and Economic Empowerment of Women Project

Another source of comprehensive information on working conditions in garment factories is an ILO technical assistance (TA) project established in January 2001 as a result of the signing of the three-year trade Agreement on Textile and Apparel on 20 January 1999 between the US and Cambodian Governments. While establishing an export quota for garments from Cambodia, the agreement mandated the effective enforcement of Cambodia's Labor Law, as well as internationally recognized basic labor standards. The project established an independent system to monitor working conditions in garment factories. During the three years of the ILO TA project's operation all garment factories were inspected at least once and eight synthesis reports with findings have been published to date. Each factory was given a copy of the report on their factory and garment buyers can request copies as well.

The Seventh Synthesis Report on Conditions in Cambodia's Garment Sector, reported as follows<sup>34</sup>:

- There is no evidence of forced labor;
- There is no evidence of discrimination, although two incidents of sexual harassment occurred;
- There is no evidence of child labor with the exception of two minor incidents;
- Non-correct payment of wages occurs frequently;
- Overtime work is not, or not always, undertaken voluntarily in a substantial number of factories;
- Freedom of association, including anti-union discrimination, is a problem in some factories;
- Overtime hours extend, either occasionally or frequently, beyond the legal limits in a substantial number of factories;
- Strikes are not organized in conformity with the legally required procedures.

The ILO project has been extended for a further period of two years, until 31 December 2005, and has launched an interesting remediation cycle of the project, following the initial cycle of monitoring, followed by suggestions for improvement. The remediation activities introduce six modules for improvement in seven garment factories and observe the impact on productivity and product output. These modules are (a) quality, (b) social dialogue, (c) productivity, (d) occupational safety and health (OSH), (e) human resources development, and (f) continuous improvement. The results in one case study show impressive results - an increase in orders and number of buyers, greater total output, reduced turnover of staff, reduced working hours, and increased worker salaries.

Over the past year ILO produced several training manuals and guidebooks that the TA Project Team used as valuable references. In addition, a study on buyer and investor intentions after the ending of the quota system is presently being undertaken by FIAS that deals specifically with the impact of the ILO monitoring for compliance program on the sourcing decisions of major buyers. The report is due for release in October 2004.

In addition, MOWVA is implementing an Economic Empowerment of Women (EOW) project, implemented by ILO with Japanese funds, that aims to empower women in the workplace, to inform them of their rights by law, and to examine how monitoring of these matters can be strengthened. Taking into account these issues, the proposed Garment Employee Development Pilot Project also addresses certain human resource issues (Annex 6).

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<sup>34</sup> While the report pertains to 61 units, the findings are more or less applicable to all units that came under the purview of the project. At the time of printing of this Phase 1 Report, the Eighth Synthesis Report was available and the Ninth and Tenth were completed but awaiting publication.

## 5. Players and Policies

This section presents an overview of the key participants in the Cambodian garment industry cluster and identifies key issues relating to each major group of stakeholders. It concludes with a description of the government's policy framework and approach to the sector.

### 5.1. The Key Players

#### 5.1.1. Garment Industry and Related Companies in Cambodia

The composition of GMAC membership by ownership is shown in Table 5.

Important features of garment industry ownership structure in Cambodia are as follows:

- 84% of GMAC members are owned by East Asian investors with only 7% being Cambodian and very small number from Europe and North America.
- Virtually all the decisions made about key issues such as financing, sales, marketing and purchasing are made by these "offshore owners"<sup>35</sup>, most of whom are Chinese, and many of these offshore owners have similar garment assembly units in other countries that are in direct competition with Cambodia.
- In general, it would be true to say that these offshore owners may not have a strong commitment to Cambodia and do not make significant efforts to create linkages or subcontracting networks with Cambodian companies.
- **Related firms.** There exist, in addition to GMAC members, a small number of SME suppliers or sub-contractors, but informal sources indicate that these number only between 50 to 100 and employ only small numbers of workers. Materials supplied domestically within Cambodia consist only of some cardboard cartons and poly bags.

Nationality	Number of Members	Total Share (%)
Hong Kong	57	29.08%
Taiwan	43	21.94%
China	23	11.73%
Cambodia	14	7.14%
Korea	13	6.63%
Malaysia	9	4.59%
USA	9	4.59%
Singapore	8	4.08%
United Kingdom	6	3.06%
Macau	6	3.06%
Indonesia	3	1.53%
Australia	1	0.51%
Canada	1	0.51%
Germany	1	0.51%
Japan	1	0.51%
Philippines	1	0.51%
<b>Total</b>	<b>196</b>	<b>100.00%</b>

Source: GMAC presentation, October 2003

**Issues:** The critical challenge is to find ways to work with the 90% of the industry owned by offshore investors and try to leverage their present involvement into (a) maintaining their activities in Cambodia, (b) expanding investments to strengthen the supply chain (c) stimulating Cambodian investors to enter the industry, and (d) support for the development of backward linkages and Cambodian SMEs.

<sup>35</sup> The firm-level survey substantiated this observation fully, with considerable evidence that the Cambodian-based operations carried out simple production activities to meet the orders being placed by the offshore companies.

### 5.1.2. The Industry Association and the Government-Private Sector Forum

**Garment Manufacturers Association of Cambodia (GMAC)** is the trade association that represents all export-oriented garment companies (about 196 companies) as well as some 59 non-exporting garment companies. GMAC is active in lobbying the government on all matters relating to the industry; advising member companies in disputes with the trade unions and/or with employees; in handling quotas and export visas, as well as taking part in bilateral negotiations. GMAC is relatively well-established but, with the exception of some interesting projects, such as the Cambodia Garment Training Center, GMAC undertakes relatively few technical support functions for its members, such as tracking business developments, providing support services, etc. In the area of trade, for instance, GMAC could assist companies in participation in international fairs and help MOC with domestic and international trade missions.

**Issue:** When the quota system is abolished the need for quota allocation by GMAC will no longer exist and GMAC will be forced to develop new activities to justify its existence<sup>36</sup>. These activities could include (a) more active tracking of industry and regional trends, (b) promotion of the garment industry overseas, (c) proactive management of the training center, (d) working closely with the public sector to develop a greater Cambodian presence in the industry, (e) more active dissemination of information to members, etc.

**The Government-Private Sector Forum:** Following the initiative of the Cambodian Prime Minister, an ambitious exercise in public-business sector cooperation is underway. Seven working groups have been set up on energy and infrastructure, agriculture and agro-business, banking and finance, laws, tax, and good governance, manufacturing and SMEs, tourism, and export processing. An AUSAID/IFC-supported expert is in place to facilitate meetings and follow-up, and some progress has been made in addressing the key issues as seen by the business community. The export processing working group is the group in which the garment industry is primarily involved, and the co-chairperson of that working group is the Chairperson of GMAC.

**Issue:** While progress has been made, the Government-Private Sector Forum needs to move beyond serving as a forum for airing grievances and become a more proactive mechanism to address problems and monitor the implementation of related reforms<sup>37</sup>.

### 5.1.3. Garment Industry Employees and Trade Unions

The number of trade unions in the garment industry in Cambodia is large, with usually one or more independent union working within each company. The independent unions are members of federations of unions, but operate independently of the federations to resolve specific issues. Typical of the union federations is the National Independent Federal Textile Union of Cambodia that represents employees in over 40 garment factories.

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<sup>36</sup> There have been extensive recent discussions of the roles of business associations in economic development in general (see Donor, Richard and Schneider, Ben Ross, Business Associations and Economic Development, Processed Report, July 2000) and in the Greater Mekong Subregion in particular (see Brimble, Peter, Business Associations and the Asian Crisis: An Action Agenda for the GMS, Presented to the Symposium on the Comprehensive Development of the Greater Mekong Subregion under the Forum for the Comprehensive Development of Indo-China (FCDI), Bangkok, April, 1999). Annex 5, derived from the two sources cited in the footnote, presents an indicative listing of the types of activities that can be carried out by business associations under two categories: (a) market enhancing; and (b) market complementing.

<sup>37</sup> A comment from one participant on the initiative is illuminating: "The working group process provides a mechanism to air views and grievances, but fails to deliver in providing concrete solutions to the problem areas". See Brimble, 2003.

All garment industry unions are affiliated with one of the five following national labor federations:

1. The Cambodian Federation of Independent Trade Unions
2. The Cambodian Union's Federation
3. The Free Trade Union of Workers of the Kingdom of Cambodia
4. The Cambodian Labor Union Federation
5. The National Independent Federation of Textile Unions In Cambodia

The five federations claim a membership that exceeds 80,000 and say that they represent more than 50% of garment industry workers. Whilst over 90% of union members are women, very few women fill national leadership positions. . None of the people serving as president, vice president or general secretary of a major trade union actually work in a garment factory. Perhaps, with their other commitments, women find it difficult to devote time to trade union activities and also are not inclined to get involved in the politics of trade unions. However, trade unions led by women were viewed by MOLVT as being more professional and perhaps more transparent, and it was felt that election of female leaders should be encouraged.

Union representatives commented during interviews that the main issues of concern to their members were:

- Overtime working is voluntary but workers are 'compelled' to work overtime on demand and up to 4 or 6 hours a day when 2 hours are the maximum legal overtime. Sometimes, in emergencies, the demand on workers is to work overtime until 06.00 hours the following day;
- Overtime rates of basic wage + 50% are not always honored;
- The language gap between Cambodian workers and supervisors is small compared to the culture gap;
- Presently, the trade unions are observers at negotiations between government agencies and stakeholders on matters that concern workers. Union representatives request to be party to these discussions so that they can contribute and be direct signatories to any legal agreements;
- The trade unions are apprehensive that the garment industry will be in a continuously weakening position if corruption and informal payments are allowed to continue, if bureaucratic procedures are not streamlined (bureaucracy requires many persons to authorize documents when only 2 or 3 are needed), if the skills of garment workers are not properly developed. The trade unions also note that no new stakeholders, either foreign or domestic, are investing in the garment industry and that some existing stakeholders are leaving Cambodia;
- Small garment companies are incapable of getting quota allocations directly and have to buy these from larger garment factories. Sub-contractors make only small profits and these are being eroded by reductions in CMT prices;
- The "immediate presence" of police at disputes between factory stakeholders and trade unions aggravates the situation and makes problems more difficult to resolve, as feelings become inflamed.

**Issue:** Trade unions could benefit from institutional strengthening to play a more proactive role in assisting their members to upgrade skills and competencies and to partake in more productive interactions with the government and the garment industry, designed at working together to create a stronger garment sector that will continue to provide better livelihoods for their members.

#### 5.1.4. The Arbitration Council

The Arbitration Council (AC) is part of the system for the amicable resolution of labor disputes set up under Chapter XII of the Labor Law and Prakas 338 of December 2002. The first AC has 21 arbitrators appointed by the MOLVT.

The objective of the AC is, firstly, to prevent disputes arising and, secondly, to resolve disputes, through a conciliation process. Experience has shown that the majority of disputes can easily escalate and that it is important to take grievances seriously in the early stages. Model grievance procedures were introduced into eight garment factories to apply conciliatory approaches to solving issues through Workers' Councils. The AC aims to train MOLVT staff in conciliation methods.

- The AC is a tri-partite body composed of members nominated by the trade unions, employer associations (GMAC) and the Royal Cambodian Government
- The AC must have at least 15 members, of which one-third shall be nominated by each of the three stakeholder groups
- The AC is an independent body in which each member is required to approach every case on merit without favor to any party
- The AC provides all parties with the opportunity to resolve disputes in an independent and impartial forum without recourse to legal or industrial action

**Issue:** The experience so far with the AC has been most encouraging and well worth continuing. Garment industry employers take the AC seriously and the results are endorsed by MOLVT. In the period May 2003 to January 2004, 30 cases came before the AC, most of which were related to the garment industry (five were in the tourist industry and one at Caltex). Most cases were resolved through conciliation. The results are posted on a website in each case, to demonstrate transparency and to share the arguments and the reasoning used in the arbitration process. Arbitration rulings are not binding and either party can object within eight days, in which case the rulings are nullified.

#### 5.1.5. Training Institutes

Although the garment industry is the engine for growth in Cambodia, investment in systematic skill development of garment employees is not commensurate with the importance of the garment industry to the economy. Training of workers is generally informal. There is no systematic training for entry into garment factories. Potential workers either pay a small fee to an outside tailor, usually US\$1 per day, for 5 to 7 days training to learn to stitch in straight lines, or workers receive on the job training as trainees after being recruited. In the case of the latter, a new employee works alongside an experienced worker and will earn wages of about US\$1 per day, usually for a period of up to 3 months although this may be extended. The average earnings of an apprentice (trainee) are US\$25-US\$30 per month for 48 hours per week (208 hours per month).

The only formal training institute is the Cambodia Garment Training Center (CGTC), located in the center of Phnom Penh, which opened in April 2002. CGTC is managed by GMAC and supported by eight organizations. These are (a) the Cambodian Ministry of Commerce, (b) the Cambodian Chamber of Commerce, (c) Garment Manufacturers Association of Cambodia (GMAC), and (d) five Japanese organizations (JETRO, Marubeni, JUKI, JODC, and AOTS).

CGTC has a large, modern lecture theatre with audio-visual equipment, a garment workshop, with a comprehensive range of cutting, sewing and pressing machines, for practical training, and a large, 60-person conference room with audio-visual equipment. The faculty includes a Japanese expert, supported by JODC, and 4 Cambodian instructors of whom one is female.

The principal course run by CGTC is 'Training of Garment Industry Supervisors' and almost 1,000 Cambodians (900 supervisors and 100 quality control students) have taken this course since the center opened. The fee (US\$112) for the 4-week (20 days) course is usually paid by the garment industry employer, and each course takes 40 students. Three days are spent on field visits to factories.

The course curriculum covers:

- Your work and workplace
- Basic management theory and improving a sewing factory
- Methods of analyzing the actual situation
- Production design
- Process control
- Quality control and inspection
- How to educate your workers (practice on sewing machines)
- Related knowledge (fiber, materials and equipment)

The course has no focus on the labor laws and workers' rights and the curriculum is revised periodically, based on feedback from students and factory managers.

At the request of GMAC, the center recently established a course for Skills Development at Entry, for which the first group of 30 students will be trained in the near future (course fee US\$75). Additional courses run by CGTC are a Basic Operator Training Course (2 weeks), a Machine Maintenance course, and short courses for Supervisors.

**Issue:** There is no doubt that CGTC makes a contribution to the necessary development of the garment industry but the TA project team findings, coupled with comments from the garment industry, are that the contribution should be much greater than is presently being achieved. The garment industry needs skills development and CGTC has the means of providing the necessary training if fully utilized. For example, the large conference room is rarely used and the view of the garment industry is that the modern (Japanese) methods of management being taught are not applicable to the (Chinese) methods currently used in the majority of the factories. One member of the faculty commented, "They have to unlearn the training once they are back on the jobs."

#### 5.1.6. Donor Agencies and NGOs<sup>38</sup>

Despite the importance that the garment industry has in the Cambodian economy, and the fact that the majority of garment industry employees come from a disadvantaged sector of society, the industry and its employees have yet to figure prominently in the active assistance agenda of international donor organizations. A number of reports have been prepared but implementation measures to date have been inadequate. This is changing, however, and more donors are coming forward to help sustain the garment industry, largely in reaction to the major changes in the market environment that will occur at the end of 2004.

The key international organization involved in the garment sector in a very significant and practical way is the ILO, supported by funds from the US and Japanese Governments (see also Chapter 4.4). The ILO major initiatives in this sector include the ongoing US\$3.6 million Garment Sector Project (GSP), being implemented over 5 years. The project is funded jointly by the US Department of Labor (US\$2.7 million), the US Government (US\$600,000), and GMAC (US\$300,000), to improve labor conditions in the garment sector. The ILO project has contributed in a major way with a systematic assessment of human resource issues and in giving Cambodia a favorable image at the international level. A recent and innovative

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<sup>38</sup> Details of certain of the more recent projects are still under development.

initiative of the ILO project is the Factory Remediation Program under which eight factories are involved in a series of training and capacity building activities. These include: (a) management systems and quality improvement; (b) social dialogue and communications; (c) working conditions and operational safety and health; (d) productivity, overtime and payroll practices; (e) human relations and organizational structure; and (f) review and continuous improvement. Additional ILO projects involved with the garment sector includes the Project for Expansion of Employment Opportunities for Women and a labor dispute resolution project.

Amongst the bi-lateral donors, USAID is active, through a CARE health care project, in about 30 factories, providing HIV and related health education services. DANIDA contributes to ILO for implementation of the Workers' Education project.

Oxfam (Hong Kong) is a very active international NGO in the garment industry. Oxfam's comprehensive Womyn's Agenda Project for garment industry workers combines research with action programs to enhance the image of garment industry workers and promote self-development.

The World Bank and IFC are focusing on trade related matters, especially on "unaccounted for costs" and delays in import/export procedures and transportation. The World Bank and IFC, in partnership primarily with the EU and IMF but potentially including other donors as well, recently supported the Royal Cambodian Government in forming a "Working Group on Trade Facilitation and Investment Climate". This working group will address the range of issues that result from the poor regulation practices that expose exporters to complex and costly import and export procedures. These excessive costs and long delays severely curtail competitiveness and must be addressed as a top priority to improve the investment climate. Box 5 presents a summary of the main measures proposed under this ambitious reform program.

<b>Box 5: Trade Facilitation and the Investment Climate: the 12-Point Plan</b>
<ol style="list-style-type: none"> <li>1. Establish a full-time, cross-agency change management team by 1 July 2004.</li> <li>2. Review and re-engineer the entire trade facilitation process to remove overlaps and unnecessary approvals and reduce both cost and time. A performance monitoring system will be put in place – with the baseline measures to start in July 2004.</li> <li>3. Implement a single administrative document by 1 December 2004 to serve as a facilitate transition to automated customs processing.</li> <li>4. Introduce an overall risk management strategy to consolidate and rationalize all inspection requirements.</li> <li>5. Carry out a strategic review of the role of CamControl to make better use of the institution's knowledge base and also optimize use of information and resources from other agencies.</li> <li>6. Implement automation of the streamlined trade facilitation process, including a single-window process in the Sihanoukville Port, by December 2005.</li> <li>7. The RCG will introduce a WTO compatible and publicly announced flat fee for services, which will be defined by a service-level agreement.</li> <li>8. Remove the requirement to incorporate with the Commercial Register.</li> <li>9. Remove the requirement to send a notification to the Ministry of Labor to start hiring employees.</li> <li>10. Automatically register a company for VAT using the same form as for company registration and associate the tax identification number with the registration number.</li> <li>11. Implement a national award for good corporate citizenship and governance.</li> <li>12. Ensure that the private sector participates in the monitoring and evaluation of reforms, through the Private Sector Forum.</li> </ol>

The Foreign Investment Advisory Service of the World Bank (FIAS) is implementing a research project on the global market premium of the corporate social responsibility that is embodied in the "Made in Cambodia" brand. As mentioned earlier, the project report is expected to be issued in October 2004 and may have valuable implications for the

recommendations of the Phase 1 report, especially with regard to the importance of Cambodia's labor compliance record as a competitive advantage.

The French Government has recently developed project proposals in a number of areas. These include: (a) support to develop the capacity for fashion design within Cambodia; and (b) support to develop labeling of Cambodian products; and (c) support the extension of the ILO Garment Sector Project's remediation program and the development of a management information system to add value to the monitoring system.

Consultations with a number of bilateral donors seeking partners for the Garment Employee Development Pilot Project revealed an increasing interest in the garment sector from additional donors, such as AUSAID and CIDA. These potential partnerships will be further developed in the next phase of the ADB TA Project and are expected to supplement the limited TA Project funds for pilot project activities.

**Issue.** The two key issues relating to donor and NGO involvement in the garment industry are, first, the need to encourage more involvement from donors in addressing the critical constraints and challenges of the garment industry and, second, the need to coordinate and channel available resources to ensure maximum synergies and effectiveness.

## 5.2. The Policy Framework and Approach

The industry policy of the Royal Cambodian Government towards the garment sector needs to be improved. While recognizing that the garment industry is the engine that has driven the Cambodian economy for the last 10 years, the public sector has little involvement in the garment industry apart from imposing bureaucratic administrative procedures on imports and exports, and carrying out numerous industry inspections and controls<sup>39</sup>. To date, there has been effectively no coherent government policy and related support measures to facilitate and support the garment industry in Cambodia.

Although outwardly favorable to foreign investors, Cambodia's very limited human resource development, delays in customs procedures, hidden transportation costs, ambiguous labor laws, poor infrastructure, shipments that must be off-loaded onto deeper water vessels in Singapore, unclear implementation procedures, and other factors, do not act as incentives to attract additional investment, either foreign or domestic.

While recognizing that the real engine of growth in the garment industry will always be the private sector, the public sector needs to make a concerted effort to redefine its role. This role must change from controlling and extorting resources from the industry and in that process severely hampering its competitiveness. The new role of the public sector should be to support business, implement policies that create an environment in which the industry can be competitive, and continue to monitor (but not control) the industry and safeguard the interests of its employees.

In the past few years, a number of initiatives have been implemented that represent a positive change and which demonstrate commitment to build partnerships with the business sector:

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<sup>39</sup> The enumeration of the numerous agencies involved in various stages of the value chain is provided in the World Bank 2003 value chain report, ranging from the CDC at the approval stage through the Customs and Excise Department and many Ministry of Commerce desks at the operational stage, and other ministries such as the Ministry of Labor at the factory inspection stages.

- The formation of the Private Sector Forum and the resulting public-private sector dialogue on key issues of importance to the garment industry (Annex 4);
- The support provided to the Cambodia Garment Training Center (CGTC) in partnership with GMAC, the foreign private sector, and the Japanese Government;
- The Integrated Framework pilot study and activities pioneered by the MOC, in partnership with the WTO, the World Bank, ITC, UNCTAD, IMF and UNDP;
- The recent formation of the Working Group on Trade Facilitation and Investment Climate to oversee an ambitious series of reforms in the trade facilitation process, with support from the World Bank.
- The recent formation of the Private Sector Development Policy and Strategy Mechanism to further strengthen the capacity of the Royal Cambodian Government to implement the ambitious reforms to facilitate business and private investment activities (Annex 4).

Another factor that must be taken into account is the increasing competitiveness of the global garment industry and the integration along supply chains that is taking place. As previously noted, it is likely that the number of “supplier countries” will drop following the ending of quotas and that serious pressures will be placed by garment buyers on the remaining countries to reduce prices and lead times. As the market changes from the present model under the quota system to the highly dynamic model expected of the post quota era, the Cambodian garment industry will have to be more responsive to buyer requirements. This will place additional responsibilities on the sectors concerned. At the same time, many of Cambodia’s competitors – from neighbors such as Thailand and Viet Nam to countries further afield such as Bangladesh and Mauritius – are already putting in place proactive policies and strategies to promote their garment industries and support them in building competitiveness.

In this dynamic and evolving environment, the Royal Cambodian Government must begin to consider and implement many more proactive policies. Not only to enhance the general business environment and remove impediments to investment, but also to address market failures and structural problems facing the garment industry through a more systematic set of policy measures and support initiatives to the garment industry<sup>40</sup>. The Cambodian garment industry has a neutral market image with a label that is mundane. Prices obtained for output are not high, as the garment industry offers nothing outstanding to buyers. The garment industry strategy must be to develop a stronger national identity that stands for differentiated products of higher value addition, smaller production runs, and rapid delivery.

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<sup>40</sup> A proposed structure and approach and framework to support the development of such a proactive policy is presented in Chapter 7 and 8.

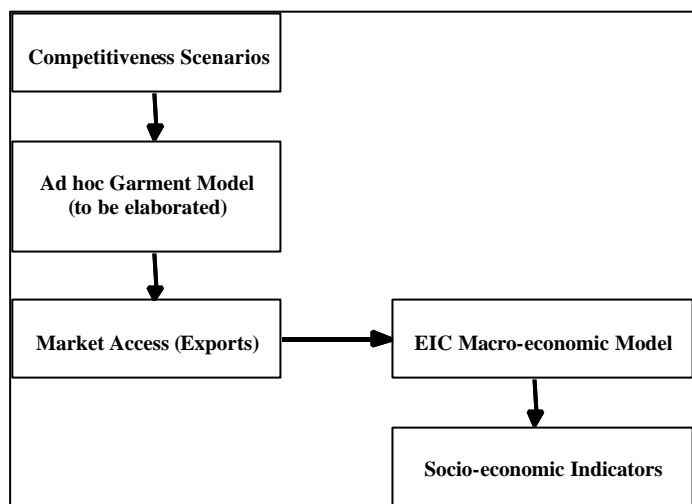
## 6. A Quantitative Analysis of Critical Challenges

To examine the likely impact of various development scenarios on Cambodia's garment industry over the next 6 years following ending of the global garment quota system, the TA project research team employed a simple but in-depth macroeconomic model to generate consistent estimates of the impact on key macroeconomic variables.<sup>41</sup>

### 6.1 The Model<sup>42</sup> and the Scenarios

The general approach is outlined in Figure 6.1. Since it was not possible to develop a model of the global garment industry itself, the TA project team decided to examine two "scenarios" that draw on expert opinion on likely developments in the competitiveness and the market access of the Cambodian garment industry and that of major competitors<sup>43</sup>. For each scenario, detailed assumptions were made of the export volumes that the Cambodian garment industry would achieve, and the prices that would be faced in the major markets, and these were fed into an "Ad-hoc Garment Model". Given the differences in types

**Figure 6.1: Garment Industry Modeling System**



and prices of products exported to the US under quota and non-quota regimes, the distinction between these two categories is maintained even though the quota system will not be in place. Also, given that Cambodia is a minor competitor in global markets, it is assumed that changes in Cambodia's production will have no impact on global prices.

The final Cambodian garment export values were then fed into the macroeconomic model to generate the expected impact of the various scenarios on a range of socio-economic variables in the overall economy and in the garment sector: GDP, government revenues, labor costs, employment, etc.

The two scenarios that were developed are as follows:

**The baseline scenario.** This scenario basically reflects an unchanged situation, and could perhaps be considered a probable scenario. This assumes overall growth of the global garment market at 5%, that competition in the US market will be intense after the end of the quota system, that levels of productivity in the Cambodian garment industry will remain the same, and that the Royal Cambodian Government takes no concrete measures to improve the business environment for the garment industry. As a result, Cambodia garment producers lose competitiveness in the world market, especially in the US market, and the TA project team forecast that Cambodia garment exports to the US market will decline by 5%

<sup>41</sup> This Chapter draws on Sok Hach and Peter Brimble, ongoing research.

<sup>42</sup> See Annex 3 for a description of the macroeconomic model that is used. Note that this is the first time that the model has been used to examine the garment industry in detail and further refinements are being considered.

<sup>43</sup> It was decided to limit the number of scenarios to two for two main reasons: first, to simplify the discussion and focus attention on the key likely developments; and second, since the number of variables are very large both in the local and international markets and the possible outcomes very uncertain.

per year, from 2005 to 2010, while the price of garment products under quota in that market will also decline by 5% per year. However, it is assumed that conditions in the EU and other markets, such as Canada, will remain relatively favorable for Cambodian garment producers. Cambodian garment exports to these markets will continue to grow at 5% per year, with a price increase of 2% per year. The assumptions for quantities and prices are in Table 6.1.

Table 6.1: Baseline Scenario: Assumptions									
		2003	2004	2005	2006	2007	2008	2009	2010
<b>Price levels (US\$/pc)</b>									
	US Quota	5.12	5.12	4.86	4.61	4.35	4.09	4.09	3.84
	US Non-quota	2.04	2.04	2.04	2.04	2.04	2.04	2.04	2.04
	EU	3.78	3.78	3.78	3.78	3.78	3.78	3.78	3.78
	Other Markets	4.32	4.40	4.49	4.58	4.67	4.76	4.86	4.96
<b>Quantities (mn pcs)</b>									
	US Quota	138.9	158.3	150.4	142.5	126.6	110.8	95.0	79.1
	US Non-quota	201.6	201.6	191.5	181.4	171.4	161.3	161.3	151.2
	EU	107.6	113.0	118.6	124.6	130.8	137.3	144.2	151.4
	Other Markets	18.2	19.1	20.1	21.1	22.2	23.3	24.4	25.6

Source: Expert opinion of project team

**The growth scenario.** This scenario is a more optimistic one for Cambodia. This also assumes that the world market for garment products continues to grow by 5% but, that while competition in the US market after the end of the quota system will be strong, with the implementation of sound economic and legal reforms Cambodia garment producers will remain competitive and maintain their market share in the world market. Specifically, with concerted efforts undertaken by both government and industry to: (a) improve productivity of the workforce; (b) work to maintain and gain greater market access; (c) reduce lead times and develop backward linkages in the industry; (d) reduce unnecessary transaction costs; and (e) address other impediments to investment, Cambodian garment exports will continue to grow by 5% per year in line with expected growth in the global garment market. The assumptions for quantities and prices are shown in Table 6.2.

Table 6.2: Growth Scenario: Assumptions									
		2003	2004	2005	2006	2007	2008	2009	2010
<b>Price levels (US\$) (increase by 2%)</b>									
	US Quota	5.12	5.22	5.33	5.43	5.54	5.65	5.76	5.88
	US Non-quota	2.04	2.08	2.12	2.16	2.20	2.25	2.29	2.34
	EU	3.78	3.86	3.94	4.02	4.10	4.18	4.26	4.35
	Other Markets	4.32	4.40	4.49	4.58	4.67	4.76	4.86	4.96
<b>Quantities (mn pcs) (increase by 5%)</b>									
	US Quota	138.9	145.8	153.1	160.7	168.8	177.2	186.1	195.4
	US Non-quota	201.6	211.7	222.3	233.4	245.0	257.3	270.2	283.7
	EU	107.6	113.0	118.6	124.6	130.8	137.3	144.2	151.4
	Other Markets	18.2	19.1	20.1	21.1	22.2	23.3	24.4	25.6

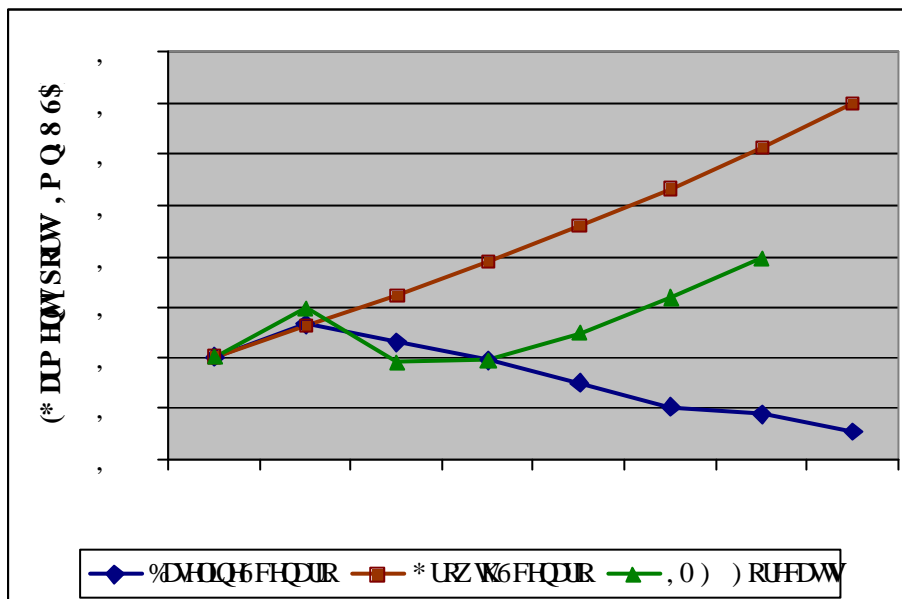
Source: Expert opinion of project team

It should be emphasized that modeling the impact of the ending of quotas at the end of 2004 on Cambodia and on international trade will be highly subjective. There is no doubt that there will be significant changes in the global market environment. Buyers around the world will have the choice to source at will after 30 years of restrictions and quota allocations. The number of variables that will influence the performance of Cambodia's garment industry are

numerous and extremely difficult to predict. These range from factors that are more or less under the control of Cambodia – such as policy reforms and productivity improvements – to factors that are not – such as the performance of China in the garment industry, the performance of other major competitors, the decisions of major markets on issues of market access, and the overall growth of the global garment industry.

In terms of the immediate changes in 2005, there has been much discussion of a dramatic downturn in exports by Cambodian garment factories in 2005<sup>44</sup>. Figure 6.2 shows the export

**Figure 6.2: Garment Industry Exports Under Various Scenarios**



Sources: Expert opinion of project team; IMF, 2004.

growth paths for the two scenarios, as well as IMF forecasts. The TA project team believes that such major changes are unlikely to occur. All changes are likely to be gradual as both buyers and suppliers will need to become accustomed to, as yet, unknown market situations. Buyers will not suddenly change orders from proven suppliers to unknown suppliers as this could cause established 'just in

time' supply channels to fail. However, some countries and suppliers will begin to benefit from the more open market while weaker garment companies will begin to lose business.

In conclusion, the TA project team believes that the analysis presented below provides consistent indications of the likely impact of two reasonable scenarios. If it is assumed that the Cambodian garment industry will perform less well than modeled in the baseline scenario, then the negative effects can easily be demonstrated

## 6.2. Analysis of Scenarios

### 6.2.1 Impact on the Garment Industry

Table 6.3 shows the effects of the two scenarios on some key indicators of the garment industry for the years 2007 (the year of the next national election) and 2010. In terms of exports the baseline will see declines of US\$110 million by 2007 and nearly US\$300 million by 2010. As previously noted, this decline of exports by around 20% is not as dramatic as in

<sup>44</sup> IMF, 2004, for example, projects a 12% decline in garment exports in 2005, and informal reports of discussions among the Cambodian garment workers in the Cambodia Daily indicate casual expectations of even more dramatic declines.

some forecasts, but the TA project team feel this serves as a good baseline scenario<sup>45</sup>. Similar declines are estimated for value added (from US\$33 million in 2007 to US\$89 million in 2010), labor costs (from US\$11 million to US\$33 million) and gross profit (from US\$14 million to US\$29million). Employment losses increase to 32,000 jobs by 2010, accompanied by declines in payrolls of around US\$33 million.

In order to highlight the “opportunity cost” to the Cambodian garment industry of not making the improvements and reforms that underpin the growth scenario, the last two columns of Table 6.3 compare the growth with the baseline scenario. The results are dramatic. By the year 2010, the difference in terms of export values is almost US\$1.3 billion, the number of additional jobs created is almost 100,000, and the additional payroll is US\$175 million.

Garment Industry Variables	Scenario	Actual			Changes		Growth-Baseline	
		2003	2007	2010	(2)-(1)	(3)-(1)	2007	2010
		(1)	(2)	(3)				
Exports (mn US\$)	Baseline	1,608	1,497	1,312	-110	-296	618	1,287
	Growth	1,608	2,115	2,599	508	991		
Value Added (mn US\$)	Baseline	482	449	394	-33	-89	185	386
	Growth	482	635	780	152	297		
Labor Costs (mn US\$)	Baseline	235	224	202	-11	-33	87	175
	Growth	235	311	377	77	142		
Gross Profit (mn US\$)	Baseline	115	101	86	-14	-29	46	101
	Growth	115	147	187	32	72		
Employment ('000)	Baseline	230	219	198	-11	-32	45	96
	Growth	230	265	294	35	64		

Source: Estimates from macroeconomic model

## 6.2.2. Impact on the Overall Economy

Table 6.4 shows the effects of the two scenarios on key indicators of the overall economy for the same years 2007 and 2010. Looking at the differences between the baseline scenario and the growth scenario, it is immediately noticeable that in 2010 a full 1.5% of real GDP growth annually would be lost by not making improvements and reforms to the garment industry. This translates into losses of US\$1 billion of GDP annually and US\$174 million of government revenues. In terms of employment, the negative impact of the baseline scenario as compared to the growth scenario would be a loss of 252,000 jobs per year, some 2.5 times the number of relatively high paying garment industry jobs alone that would be lost.

Macroeconomic Variables	Scenario	Actual			Changes		Growth-Baseline	
		2003	2007	2010	(2)-(1)	(3)-(1)	2007	2010
		(1)	(2)	(3)				
Nominal GDP (mn US\$)	Baseline	4,000	4,680	5,350	680	1,350	340	1,000
	Growth	4,000	5,020	6,350	1,020	2,350		
Real GDP Growth (%)	Baseline	5.0%	4.0%	3.5%	-1.0%	-1.5%	1.0%	1.5%
	Growth	5.0%	5.0%	5.0%	0.0%	0.0%		
Government Incomes (mn US\$)	Baseline	430	540	610	110	180	50	174
	Growth	430	590	784	160	354		
Total Employment ('000)	Baseline	5,480	5,686	5,787	206	307	101	252
	Growth	5,480	5,787	6,039	307	559		

Source: Estimates from macroeconomic model

<sup>45</sup> Interviews with senior industry representatives indicated a worse case scenario of a decline of up to 50% of exports (and employment) by the year 2010. This scenario would clearly result in much greater negative impacts both on the garment industry and on the overall economy.

### 6.2.3. Impact on Gender and Poverty<sup>46</sup>

While the impact on poverty by the employment generated by the garment sector has not been systematically quantified at the macro level, it is obvious that the personal situations of garment industry employees, as well the rural households they support, will be transformed if the baseline scenario is realized. The SESGEC indicates that about 50% of monthly wages are sent home by a largely female garment industry workforce that come from Cambodia's rural areas. It is clear that the absolute declines in jobs and incomes, and therefore also in remittances, will translate directly into lower incomes for women and for poor rural households. For example, the over US\$30 million of labor cost declines by the year 2010 in the baseline scenario would translate into reductions in remittances of around US\$15 million. It is likely that the social impact of the increasing joblessness (with a decline of more than 32,000 jobs in the baseline scenario by 2010) would be great as large numbers of young women are thrown into an employment market that has few opportunities for them. As these young women do not possess skills for alternate employment and cannot easily go back to their villages, some NGOs working directly with garment employees (e.g. Oxfam) fear that large numbers of women would be pushed into unsuitable or exploitative employment. This analysis also only takes into account direct employment in the garment industry.

If the growth scenario is compared to the baseline scenario, the opportunity costs of not undertaking the reforms necessary to improve competitiveness of the garment industry are even more dramatic. If the growth scenario is achieved, it is estimated that around US\$90 million of the differential wage costs of around US\$175 million would be remitted to rural areas. Almost 100,000 more jobs would also be generated in the growth scenario compared to the baseline scenario, more than 85% of them being for women.

### 6.3. Major Conclusions

The modeling exercise has confirmed many forecasts. The negative impact on the Cambodian economy of not addressing the various impediments and inefficiencies in the garment industry is significant – amounting to a loss per year of 1.5% of GDP and up to 250,000 jobs. It is likely that most of the impact would fall on women and the poor. Perhaps of more concern is that these figures are based on a baseline scenario that is somewhat more favorable than many predictions.

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<sup>46</sup> Considering the importance of examining the gender and poverty impacts of the various scenarios of the macroeconomic model, the TA Team plans to undertake additional macroeconomic analysis to focus on the issue. Efforts are underway to partner with a group of economists at Sussex University who have modeled the effects of trade on women at work and at home (see Fontana and Wood, 2000). In order to examine the gender and poverty impacts of the various garment industry scenarios, specific modules to model these characteristics would need to be developed. This would require additional information through spot surveys around the garment factories.

## Part 3: Conclusions and Recommendations

### 7. Main Conclusions and Core Vision

The Cambodian garment industry has achieved a great deal during its short history. The garment industry has become the engine driving the national economy, making the greatest national contribution to poverty reduction by having created some 230,000 direct jobs, probably with as many indirect jobs again, and generating the majority of Cambodia's foreign currency earnings.

However, the global market environment is in a transitional stage with the ending of quotas coming about at the end of December 2004 and these changes will create new challenges for the garment industry. The quota premium cost competitive advantage will disappear and, although Cambodia will continue to enjoy some preferential market access, suppliers offering lower costs through higher productivity levels and shorter lead times will gain the advantage.

It should be emphasized that the position of Cambodia's garment industry is unique:

- This is a pre-eminent garment industry accounts for around 12% of GDP, almost 80% of exports, and 65% of manufacturing sector employment, yet the garment sector is built essentially on the basis of the quota system and relatively small comparative advantages in terms of labor cost.
- The garment industry is essentially dominated by offshore owners that also have garment units in other countries and who carry out all marketing and financing decisions. Few domestic investors have taken a significant interest in the industry, for historical and political reasons.
- Few backward linkages exist and, therefore, lead times are almost exclusively based on imported materials, resulting in extended and unreliable delivery times.
- Labor productivity in the garment industry is amongst the lowest of the competing countries.
- Global markets will change extensively and rapidly in the near future as textiles and clothing quotas are ended.
- Cambodia has no major unique market cost position, and although labor compliance is a positive feature, the industry is likely to need to continue to depend on preferential market access for the foreseeable future. During that period of reliance, the Cambodian garment industry needs to become more competitive in terms of cost reduction and delivery times or sections of the industry will fail.

How the domestic garment industry responds to the market changes will depend on the strategies of offshore investors and of the Royal Cambodian Government. Field survey work indicates that the majority of factory managers in Cambodia appear to be adopting a "wait and see" position, while the decisions of offshore investors are likely to respond more quickly to global developments in the garment industry. With regard to government policies, with bureaucrats well known for delaying shipments or orders, significant reforms are called for in order to prevent garment business moving away from Cambodia as the garment industry's competitiveness steadily declines.

If improvements are not made, then the numbers of direct and indirect workers in the garment industry will fall sharply, and the economy of Cambodia will be seriously damaged

(see Chapter 6). It is anticipated that the Royal Cambodian Government will want to ensure that this situation does not arise and that positive progress will be made.

Box 7 draws together the main findings of all the analysis to date in a strengths, weaknesses, opportunities and threats (SWOT) framework.

The basic elements identified in the SWOT table are already outlined in this report. However, drawing together the key findings and prevailing constraints supports the view that, in order to maintain and develop the existing market share, the Cambodian garment industry must identify and exploit opportunities in niche markets that suit the existing industrial base and capabilities.

### Box 7: SWOT Analysis of the Cambodian Garment Industry

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Some acquired know-how and experience in the industry, including within the semi-skilled labor force</li> <li>• Strong offshore investors with technical and commercial know-how and capital resources</li> <li>• Current preferential regimes in terms of quota and duty-free access – to the US, EU, Canada, Australia, New Zealand and Norway</li> <li>• Large pool of unskilled cost-effective labor available from the rural areas to support expansion of the industry if required</li> <li>• Large levels of exports and experience in the export markets</li> <li>• Positive market image, especially in the area of labor utilization and compliance</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Industry heavily focused on cut, make and trim (CMT) garment manufacture, with all major decisions across the board taken off-shore</li> <li>• Lack of inter-industry linkages and few serious subcontractors, and policy impediments to backward linkage development</li> <li>• No Cambodian lead investors in the industry</li> <li>• Low level of human resource development and low skill base resulting in low productivity and higher than necessary costs</li> <li>• Shortage of skilled middle-management/shop floor supervision/skilled workers</li> <li>• Heavy use of expatriate supervisors leading to culture and communication gaps</li> <li>• Seriously low levels of local value added, and low levels of technology as well</li> <li>• Longer lead times than competitors</li> <li>• High levels of official and unofficial transactions costs, especially in the import/export processes</li> <li>• High costs of power and other utilities</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Potential to enhance the productivity of the labor force through training and better human resource practices</li> <li>• Potential in the EU market as former Eastern European members of the EU become less competitive</li> <li>• Potential in the US market, especially if preferential access to this market can be enhanced</li> <li>• The establishment of an Export Processing Zone</li> <li>• Investment in backward linkages</li> <li>• Regional integration with ASEAN countries and ASEAN cumulation</li> <li>• Benefits of WTO membership</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Performance of competitor countries, such as China, Bangladesh, Vietnam, etc.</li> <li>• Unwillingness of local investors to enter the garment sector</li> <li>• Phasing out of preferential market access agreements</li> <li>• Possible instability resulting from labor disputes and the high costs resulting from certain provisions in the labor law</li> </ul>

Source: Fieldwork interviews, desk research

The following vision statement is proposed:

**The Core Vision:** Create an environment in which the Cambodian garment industry can develop export competitiveness in niche markets and empower garment industry employees by fairly distributing the benefits

The key objectives of the core vision, and all the measures proposed to achieve these goals, will be to continue to increase exports, improve human resource practices, and generate new jobs. Table 7 summarizes the expert conclusions of the TA project team with regard to target export levels – both in total and in terms of movement away from the low value-added woven garment sector towards higher value-added knit, cut and sew garments and knitwear garments. In terms of the overall target, this amount corresponds to the value achieved in the growth scenario profiled in Chapter 6.

**Table 7: Target Exports for 2010**

	<b>2003</b>	<b>2010</b>
<b>Garment exports</b> (US\$ mn)	1,540	2,600
Of which:		
1. Woven garments	980 (64%)	950 (42%)
2. Knit cut and sew garments	350 (23%)	750 (33%)
3. Knitwear garments	210 (13%)	550 (25%)
<b>Share of global foreign trade in garments</b> (%)	0.74	0.80
<b>Local value added</b> (US\$ mn, approximation)	490 (32%)	1,100 (42%)
<b>Employment</b> (persons)	230,000	294,000

The following Chapter develops a Cambodian Garment Industry Development Strategy that is designed to exploit strengths, address weaknesses, take advantage of opportunities, and counteract threats.

## 8. Key Recommendations: Cambodian Garment Industry Development Strategy

A new strategy is required for the Cambodian garment industry as the quota system ends. The garment industry is on the verge of either further development or severe decline.

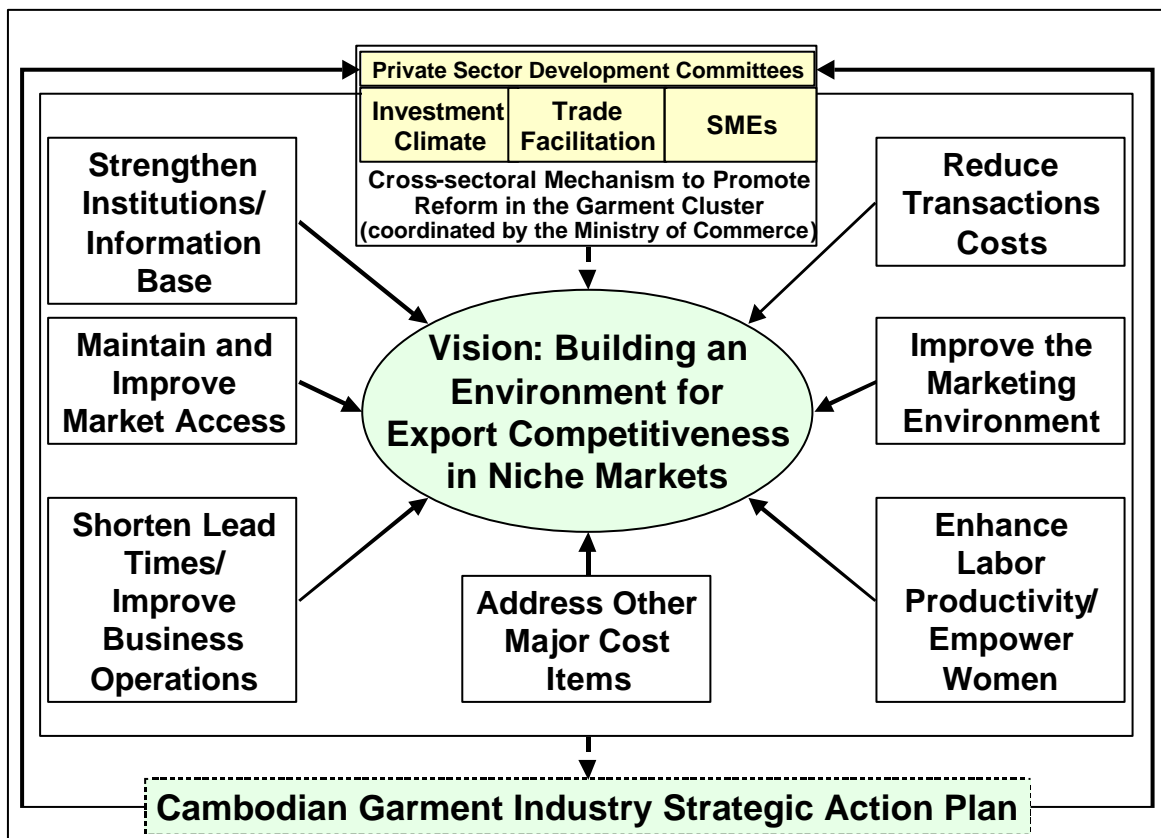
The Cambodian Garment Industry Development Strategy (Development Strategy) should focus on addressing the competitiveness of the industry and on developing policies and actions to address key weaknesses and to harness key opportunities. The Development Strategy must recognize the cross-sectoral nature of the proposed policy measures and actions and should focus on all aspects of the garment industry cluster. A set of actions in a Strategic Plan must be developed, with clearly defined and delegated tasks to ensure that outlined actions and policies are properly implemented.

Broader macroeconomic and infrastructure investment impediments (see Chapter 2) need to be addressed simultaneously with proposed garment industry reforms to guarantee success. If only the garment industry takes corrective action in accordance with the new strategy but policy framework remains unchanged, the impact will be limited.

The seven major elements of the Cambodian Garment Industry Development Strategy are presented in this Chapter. These have been developed from the analysis carried out in the TA project and from the findings of related studies. Each element of the Development Strategy is given a specific time frame: short-term – 6 months; medium-term 6 months – 2 years; long-term - > 2 years. The Chapter concludes with the outline of a mechanism to begin and implement the reform process.

Figure 8 presents the elements of the Development Strategy and the recommended institutional framework to implement it. The framework builds on the core vision, and calls for a cross-sectoral mechanism coordinated by MOC, to implement the Strategic Action Plan.

**Figure 8: The Cambodian Garment Industry Development Strategy**



## 8.1 Strengthen the Necessary Institutions and Build an Information Base

An important element of the Development Strategy will involve bringing key stakeholders into the development and implementation of actions and policies to enhance the competitiveness of the garment sector. In this process, a number of important aspects will need to be considered (in the short to medium term):

First, the development of high-level and cross-sector comprehensive policy reform and a donor coordination mechanism to (a) oversee implementation of the elements of the Action Plan, (b) coordinate and plan allocation of donor interest and resources to the garment industry<sup>47</sup>, and (c) develop an action oriented public-private sector dialogue.

Second, strengthen GMAC, the dedicated trade association of the Cambodian garment industry. In the post-quota period GMAC's role will be less that of lobbying government and more of providing the garment industry with market research data and skill development services, of interfacing with government and trade unions on behalf of members, and of undertaking trade promotion and participation in international fairs. See Annex 5 for a list of the wide range of activities that business associations can carry out.

Third, strengthen skill development institutions for entry-level training, for enhancing skills for increased productivity and, to a lesser extent, for preparing garment industry employees for employment in other growth sectors.

Fourth, strengthen employee organizations, as these also become more active in undertaking initiatives to strengthen productivity.

Fifth, development of an information and analytical base on the Cambodian garment industry, both (a) on the activities within the industry, including information on suppliers of products and services used in the garment industry; and (b) on the activities of the various donors. GMAC could play a critical role in developing these information bases, drawing together the information available within GMAC, from the Cambodian Ministry of Commerce, from the Cambodian Investment Board, from the Cambodian Department of Customs, and from other sources both domestic and international.

Sixth, development of an information base on international market data<sup>48</sup>, possibly within GMAC, on global trends in the garment industry, on developments in preferential market access schemes and the multi-lateral trading system, on sourcing possibilities in neighboring countries, and on benchmarking Cambodia against major competitors<sup>49</sup>. This information base would be designed to serve both members of GMAC and the public sector, and with information on the domestic garment industry this could be disseminated to some degree through the Internet.

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<sup>47</sup> An important first step in this element will be to compile a simple database of all the donor and NGO and government programs relating to the garment industry. This information should include at least: (a) donor/NGO name and contact; (b) name and time frame and funding level of the program/activity; (c) description of main elements of the program/activity.

<sup>48</sup> In due course, it is hoped that this information base will be of value both to the public sector and private sectors (especially GMAC) as they come to grips with developments in the global market for textiles and garments, and develop strategies to cope with them.

<sup>49</sup> Knappe, 2002 reports that GMAC will be the focal point for the implementation of the International Trade Center benchmarking tool called "The FIT". Once implemented, this could be a most useful market tool for the industry.

## 8.2 Maintain and Improve Market Access

There is considerable evidence that close partnerships between the public and private sectors, in the form of immediate negotiations and lobbying, could play an important role in capturing for the Cambodian garment industry more favorable market access to the major markets. Ultimately, market access is one important key to the garment industry's successful performance.

The activities required in the short-medium term include:<sup>50</sup>

- Building on and supporting the garment industry-financed lobbying efforts in the US market to obtain GSP duty-free market access similar to that obtained by AGOA countries.
- Campaigning for reform of the EU market access scheme, including: (a) relaxing the rules of origin of the ASEAN cumulation requirements and, in particular, including China as a qualifying input supplier; and (b) reducing the domestic content requirements for GSP duty-free access from existing levels of 50-60% to a lower level that would benefit higher value-added products from Cambodia.

## 8.3 Reduce Transaction Costs

The changes recommended are significant with regard to the costs of doing business, bureaucratic delays and unofficial costs that damage the image that Cambodia presents to buyers and investors.

The recommended changes include:

- In the short-term, explore as a matter of urgency the possibility of using bonded warehouses as a means of reducing the steps required to process imports and exports, including the possibility of customs clearance at garment factories instead of at the port. Reduce the level of unofficial payments and urgently evaluate alternative mechanisms to streamline, make transparent, and computerize import/export documentation procedures to expedite shipments (including all references to "quotas" in the post-quota environment)<sup>51</sup>.
- In the medium-long-term, provide full support to the range of reforms being implemented with support from the World Bank and several other donors (see Box 5.1 for a summary of the measures).

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<sup>50</sup> A concern here is, however, that other supply countries may have similar claims for preferential access as Cambodia and if all are granted the same or similar benefits, the overall situation will not change. This makes it imperative for Cambodia to make the internal adjustments to costs and performance required to improve the competitive situation.

<sup>51</sup> The recent commitment by the Prime Minister (Hun Sen, 2004) is particularly welcomed: "(i) the introduction of a joint inspection by CAMControl and the Customs and Excise Department effective from 1 September 2004, and issuing only one common inspection report; (ii) based on this common report, MIME and MOC will issue the Certificate of Processing (CP) and Certificate of Origin (CO) respectively, and other related documents such as visa on C/I or E/L to exporters immediately, while the two ministries will jointly conduct post-export inspection." Indications from industry interviews in early September are that these measures are already having beneficial impacts.

## 8.4 Shorten Lead Times and Improve Business Operations

A critical element of the Development Strategy must involve improvements in the manner in which business operates and also creating an environment that is conducive to the reduction of lead times, which are already important and will become more so in the future. This element of the overall Development Strategy is complex and complicated and addresses a number of critical constraints. First, the need to deepen the supply chain to build greater value-added and reduce lead times, and second, the need to attract Cambodian investors into the garment industry and in the supply of inputs and ancillaries; and third, the need to leverage existing resources in the garment industry.

The components of this element of the Development Strategy should include:

- In the short-term, implementation of an investment promotion drive to create awareness of the Development Strategy and the commitment of the Royal Cambodian Government. The following activities are recommended:
  1. Implementation of an investment promotion activity to domestic investors (both male and female entrepreneurs) and potential foreign joint venture partners. This will involve the preparation of investment opportunity profiles for selected economic-size model factories to support efforts to attract Cambodian investors to various parts of the garment value chain, to stimulate the growth of backward linkages, and to improve lead times in the industry;
  2. Visits to Cambodia-based companies that have been receiving approvals for large investments, apparently for backward linkages, to understand what these projects how they relate to the development of backward linkages in the garment industry;
  3. Visits to, the mainly East Asian, offshore owners of major garment manufacturers in Cambodia;
  4. Targeted investment promotion visits to other potential investors in neighboring countries and selected locations in Europe and elsewhere. These visits could include companies seeking to relocate dyeing and finishing plants from higher cost countries, e.g. from the EU, Singapore and Malaysia, and preferably with the foreign company investing in Cambodia with used plant and domestic partners on a joint-venture basis. The opportunity for the transfer of plant is much more likely in 2004 than in 2005, as companies planning to close their plants in higher cost countries will make their decisions this year.
- In the medium-term, the promotion of investment in backward linkage development (especially in the knitwear segment) with the explicit involvement of both foreign and domestic investors. In addition to promotional activities, carefully explore the feasibility of a “Garment Industry Investment Fund” to address market failures in the Cambodian investment environment (in terms of raising finance domestically) and support investments in backward linkages in the garment industry (especially to encourage domestic investors to enter the industry)<sup>52</sup>.
- In the medium-term, integrate SMEs more closely into the garment industry cluster. There are many small and medium-sized companies in garment (and non-garment) manufacturing that are of less than economic size, either in technical terms or from commercially. These companies could, if ‘clustered together’ in some form, increasingly contribute to export sales, as in other countries. The precise form of clusters will depend on the specific needs of the companies concerned. Cluster options will be varied and could include (i) bringing companies together under one roof, (ii) to organizing a common marketing activity, and options to be determined following discussions with interested companies.

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It is understood that there already exists an SME investment fund supported by German resource that has not been successful in finding investments. Perhaps this fund, possibly with inputs from some of the major garment investors and interested donors, could form the basis for the Garment Industry Investment Fund.

Two key policy reforms would be required to achieve this:

1. First, the present investment promotion code involves very high minimum levels of investment that strongly discourage SMEs from entering the garment sector. The Cambodian Investment Board, in its development of the new investment conditions, should carefully consider revising these high minimum investment levels significantly downwards, for example from US\$1 million to US\$25,000.
  2. Second, the VAT imposed on sub-contracting arrangements should be refunded more promptly and completely, or perhaps sub-contracting activities could be exempt from tax.
  3. In addition, a recent ADB TA study for the Cambodian Ministry of Industry, Mines and Energy (2004) on SMEs proposed an innovative set of measures to remove additional impediments to SME development. The garment industry should support such measures where relevant.
- In the medium-term, strengthen supply chains through better regional integration into ASEAN, in particular Thailand, Viet Nam, and Indonesia. It is necessary to carefully identify Cambodia's agenda in each market and then to make sure that it is realized. In the Thailand, for example, this could involve a combination of supply arrangements to speed up delivery of certain inputs into the production process and the relocation of Thai garment producers to industrial zones just over the border in Cambodia. In Viet Nam, this could be to take advantage of the need for Vietnamese garment producers to use offshore locations to be able to access markets and their willingness to provide cheap inputs such as electricity. The potential impact of the proposed ASEAN-China Free Trade Agreement must also be taken into account.
  - In the long-term, through expediting and promoting export processing zones projects that have under consideration for some time already<sup>53</sup>. EPZs offer the potential to bring together in one geographical area all elements of the garment cluster – the garment companies themselves, SME suppliers, service providers, training institutes, involved government agencies, etc.

## 8.5 Improve the Marketing Environment

Among garment buyers globally, the label "Made In Cambodia" has become synonymous with labor compliance and quality. However, beyond this relatively small group of buyers, the prevailing image of Cambodia in the global market-place is generally not a positive one, and does not reflect the reality of Cambodia as a suitable location for garment production with high levels of compliance with international labor conventions. In addition, as is evident from analysis of export markets, Cambodia remains highly dependent on the US and EU markets.

Two sets of related activities have been called for by GMAC and should be considered, both would be more practical if the presence of domestic investors in the market was greater.

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Industry interviews suggest that a large number of existing garment producers would be willing to move into an EPZ immediately if the infrastructure were in place.

These activities are:

- First, in the short-medium term, the Royal Cambodian Government and the private sector should consider establishing a marketing plan to promote the “Made In Cambodia” garment label as a brand that represents compliance, quality, reliability and service<sup>54</sup>. This could be supplemented by the development of a sophisticated labeling campaign (involving the design and production of high quality Cambodian labels for certain select products) that will create and enhance a distinctive image for Cambodian garment products<sup>55</sup>. This must, of course, be designed to complement the existing marketing strategies of the major offshore producers and buyers, and should not compromise sourcing strategies.
- Second, in the medium term, the proposed image building campaign could be complemented by an ongoing and sustained export promotion campaign. This would be based on careful research of the potential markets and product opportunities, carried out in close collaboration between the garment industry and the RCG, and aimed at diversifying export markets for garment products made in Cambodia.

## **8.6 Enhance Labor Productivity and Empower Women**

The largely female workforce is the backbone of the garment industry in Cambodia; however, low levels of labor productivity will increasingly become a major constraint to the growth and competitiveness of garment companies in Cambodia. The overriding need is to establish a comprehensive skills development program to improve motivation and productivity levels. Some of the elements of such a program are being addressed through two Pilot Projects under the ADB TA Project (Annexes 6 and 7).

These activities should include:

- In the short-term providing financial support to train more garment employees and related workers:
  1. Under the Garment Employee Development Pilot Project, recognize the need for systematic training at entry level and immediately increase training courses that the CGTC has designed for basic operators.
  2. Set up a Scholarship Facility immediately to enable suitable candidates to seek training at technical institutes in the region. For example, links can be established with training institutes for new product development in India, such as the Indian National Institutes of Fashion Technology (NIFT), and in Thailand and other ASEAN countries. The graduates of these institutions are internationally recognized.
- In the short-term, address various issues related to the Labor Law working in close collaboration with donors and NGOs already involved in the garment industry. The Labor Law was promulgated in 1997 and has a number of ambiguous sections or unrealistic conditions that have created difficulties in the garment industry. An immediate analysis of the law and its application in the garment industry will be carried out by the Labor Law Analysis Pilot Project (Annex 7). This analysis is intended to support tripartite activities to improve the law and reduce the number of strikes arising from differing and contentious interpretations of the Labor Law by stakeholders. The Pilot Project will also consider the implementation of labor laws as related to female employees, such as access to adequate reproductive health facilities, maternity benefits, child care, the presence of only male staff for security checks, personal security, etc.

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<sup>54</sup> This could link with the reported Foreign Investment Advisory Service (FIAS) project on the global market premium of the corporate social responsibility that is embodied in the “Made in Cambodia” brand.

<sup>55</sup> It is understood that the French government is interested in supporting this type of activity.

- In the medium-term, put in place programs to assist displaced garment workers to find employment outside the garment sector, such as in agro-business, tourism, and other sectors. This contingency exercise will minimize the impact on poverty levels as a result of any decrease in jobs in the garment sector. In this process, which will be initiated by the Garment Employee Development Pilot Project (Annex 6) and NGOs, and the private sector will be encouraged to improve the situation of garment employees and invest in development of the garment sector.
- In the short to medium-term, address the wide-ranging issues related to human resource practices and working conditions. This element should include the development of a sustainability strategy for the unique model on labor compliance and remediation that has been developed jointly by the RCG and the ILO. In addition, the ILO is presently implementing an ambitious project that involves in-depth analysis of these issues in eight, selected garment factories. The findings of this action-oriented project need to be endorsed and widely disseminated in order to take advantage of the potential to significantly increase labor productivity.
- In the medium to long-term, develop a comprehensive human resource development strategy for the garment industry. This would involve a combination of greater incentives for upgrading skills and technological capability in the garment companies, combined with the development of more effective training institutions. There is considerable evidence regionally that innovative support programs to industry – in particular grant-based programs - can result in considerable upgrading of skills and capacities, as well as the development of new training institutions.
- In the medium to long-term, consider the establishment of a Garment Product and Design Institute to address the complete lack of indigenous designers or training facilities for new product development. This could be established jointly with the garment industry and perhaps with the support of the French government, which has shown interest in supporting similar innovative activities in the garment sector.
- In the medium to long term, create opportunities for the development of female entrepreneurs to start small and medium sized enterprises in the garment industry and related activities. Similar efforts, involving the development of entrepreneur development programs for women and the formation of female entrepreneur organizations, have created significant opportunities for women in Bangladesh, India and Pakistan. This could include developing investment promotional packages for distribution among potential women investors. These activities could also be linked to the broader ADB support program in the SME sector.

## **8.7 Address Other Major Cost Items**

While there are a number of other cost items that are of concern to industry in general, two of these have been identified as important for the garment and textile industries and need to be addressed. These are:

- First, the extremely high cost of electricity, something that may not be that important to the garment industry but which is important to backward linkage activities that are more capital and energy intensive. In many of these activities power costs are the second highest cost after raw materials, and often more than 15 times that of labor. A number of solutions have been discussed, ranging from liberalizing the market for fuel oil to locating factories close to the borders with countries that can supply cheaper electricity.
- Second, the unofficial costs in transportation of a container from a factory to and through the port of Sihanoukville and onto a ship. Analysis of the costs and times required for the transfer of a container from a garment factory onto a ship to Singapore is recommended and, based on the findings, changes should be proposed, agreed and implemented.

## 8.8 Implementation of the Cambodian Garment Industry Development Strategy

The first step towards implementation of the Cambodian Garment Industry Development Strategy will involve the preparation of a Cambodian Garment Industry Strategic Action Plan based on the reform measures outlined above. The ADB TA Project team, following the indicative structure presented below, will formulate a working draft of the Strategic Action Plan with details on the suggested measures. However, it is critical that the final version of the Strategic Action Plan is developed and owned by the Cambodian garment industry public and private sector stakeholders.

Action /Measure	Implementing Agency	Resources Required	Implementation Time Frame	Remarks/ Action

For the second step, and as indicated in Figure 8, it is recommended that the high-level, cross-sector comprehensive policy reform and donor coordination mechanism be coordinated by the Cambodian Ministry of Commerce. This mechanism should explicitly utilize and involve the three Sub-Steering Committees formed under the newly-formed Private Sector Development Policy and Strategy Mechanism (dated 26 July 2004), namely (a) Investment Promotion and PPI; (b) Trade Facilitation; and (c) SMEs<sup>56</sup>. It is proposed that each of the policy recommendations be allocated where possible to representatives on one of the three Sub-Steering Committees to take primary responsibility for the development of more detailed action plans and subsequent implementation. This will permit the cross-sectoral recommendations related specifically to the garment industry to be implemented quickly and efficiently. Recommendations that do not fall naturally under any of the three Sub-Steering Committees could be allocated for action to the relevant ministry or agency. In all activities the involvement of the private sector in general, and the Garment Manufacturers' Association of Cambodia (GMAC) in particular, should be given high priority. As explicitly stated by the Prime Minister (Hun Sen, 2004), this involvement of the private sector could be accomplished through links to the Government-Private Sector Forum and Working Group Seven on Trade Facilitation and Processing for Export (see Annex 4).

<sup>56</sup> See Annex 4 for details on this initiative and recent developments.

**Annex 1**  
**The National Workshop: The Garment Industry in Cambodia**  
**“The Engine for Further Sustained Growth of the National Economy”**

A one-day National Workshop sponsored by the Asian Development Bank and Ministry of Commerce was held at the Intercontinental Hotel in Phnom Penh on 12 February 2004 to present the preliminary findings of the ADB TA Project investigative phase and the emerging directions for action. This was also an occasion for the garment industry, as well as different Royal Cambodian Government Ministries, to respond to the views of the consultants and emerging recommendations.

Of the 300 invitees, 230 participated in the deliberations. These included 59 government officials from various Royal Cambodian Government Ministries, ADB Resident Mission and 5 donor representatives, 116 GMAC members and factory managers, 7 union representatives, 11 NGOs, 3 vendors, and 16 other individuals from factories.

His Excellency Cham Prasidh, Cambodian Minister of Commerce, in his opening remarks said, “Who, even in their wildest dreams back in the mid 1990s, would have predicted that garment export sales would reach US\$1.6 billion within 10 years and that the industry would employ some 230,000 direct workers? And yet that was achieved in 2003.” Further, he said that Cambodia had an enviable image as the one of the most, if not the most, labor compliant of garment industries in the world. However, he also recognized that such progress had not been without its problems and these needed to be resolved immediately, before the industry moves into the next phase of expansion. He emphasized that it was now time for Cambodia’s position in the global garment markets to be re-assessed and to identify the strategy that would be most appropriate for 2005 and beyond.

The TA Project Team presented preliminary ideas on the possible future scenario on the basis of the investigative phase and the ending of the quota system in December 2004, in order to be able to assist exporting garment companies to promote the “Made In Cambodia” brand label as a symbol of compliance, quality, reliability and service. The key elements of the proposed Garment Employee Development Pilot Project were also presented.

During a session of open discussions, GMAC, MOC, Ministry of Industry, Mines and Energy, MOWA, MOL, factory managers, union leaders and NGOs, all provided valuable input. It was notable that so many from the garment businesses participated in the workshop, perhaps reflecting the concerns of both industrialists and the Royal Cambodian Government, to “save” the export oriented garment industry of Cambodia that has contributed so significantly to the national economy.

The consensus of opinion was that the Cambodian garment industry was facing difficult times with the ending of quotas and that changes were urgently needed in the short term. Many necessary changes were discussed including: streamlining import/export documentation and reducing associated costs; reducing the costs of transportation to and from the port; reviewing labor laws, especially with regard to night shifts and overtime rates; addressing low productivity levels; and reducing the cost of power, especially for machine intensive manufacturing in the textile sub-sectors. Concern was also expressed over the extended lead times of Cambodian garment factories that make them less competitive than factories in competing countries that have domestic material supplies.

## **Annex 2**

### **Notes on the Company-Level Survey**

#### **Basic Approach**

The basic approach was to meet with senior management of garment companies in Cambodia, discuss with them the major issues that they face, and determine their companies' plans for the Post Quota Era.

The concept was to have a structured discussion rather than present a detailed written questionnaire, as it was recognized that the written format was likely to be unsuccessful in eliciting the type of information required.

The representative sample of companies was selected according to (a) the size of the company – small, medium and large (b) the three sectors of the garment industry - woven cut and sew garments, circular knit cut and sew, and knitwear garments; (c) location of the company, with companies outside of the capital city, for example in Sihanoukville, being included in the sample; and (d) nationality of the investor. In this way, the TA Project Team planned to obtain a broad cross-section of views.

The final group of companies to be interviewed was selected by the TA Project consultants in conjunction with GMAC.

In total 22 companies were interviewed formally and discussions were held with other companies on an informal basis at meetings called for other reasons during the study period.

The TA Project Team is most grateful to all of the company senior management who agreed to be interviewed; the candor with which they expressed their thoughts and the generosity with which they gave their time was much appreciated.

#### **Interview Guide**

1. What were the factors that persuaded your company to invest in Cambodia?

If not mentioned in the open discussion, raise the topics of:

- Quota/non quota availability
- Preferential market access
- Competitive wage costs
- Foreign investment welcome
- WTO membership

2. Has the company been successful with its Cambodian production base?

If not mentioned in the open discussion, raise the topics of:

- Has your Cambodian factory had advantages that the other manufacturing units in the group did not have?
- If so, what?
- Will any such advantages continue in the future?
- What have been the weaknesses? Productivity, skills levels, Cambodian management, need for expatriate management, others?
- Others

3. Does Cambodia have advantages over other countries in which your company has a manufacturing base?

If not mentioned in the open discussion, raise the topics of:

- Productivity
- Competitive wage costs
- Delivery lead times
- Import / export / customs procedures and delay factors
- Bureaucratic procedures
- Corruption
- Local materials and accessories supplies
- Human resources availability and skills development facilities (production workers and management)
- Others

4. What are the main issues that impact on your business in Cambodia?

If not mentioned in the open discussion, raise the topics of:

- Productivity
- Working environment; large-sized companies vis-a-vis medium- sized companies
- Labor laws
- Strikes, union officers' activities
- Delivery lead times
- Reliability (because of inadvertent delays with imports)
- Bureaucratic procedures, informal payments
- Transport costs and delays
- Infra-structure weaknesses
- Others

5. What is the strategy for your company up to and beyond the ending of quotas?

- Do you expect that Cambodia will be an attractive manufacturing base in the future?
- Have plans been formulated?
- If not, when do you anticipate a future strategy will be developed?

### **Key Observations**

While no garment companies are identical, it was notable that the Cambodian garment companies interviewed shared remarkably similar philosophies and concerns about the environment in which they are operating.

First, it needs to be stressed that the reasons for these companies being in Cambodia are the same; (a) quotas and duty free access to the major markets; (b) competitive wages; (c) availability of female labor in large numbers; and (d) a government that outwardly welcomes foreign investors.

Second, the method of operation of these companies is very similar. The Cambodian-based operations are essentially production units with offshore head offices where all business, strategy, marketing/sales, materials procurement, and financial decisions are taken. Local management in Cambodia is only responsible for managing the manufacturing units on budgets provided by the offshore head office, for receiving production orders and pre-ordered materials through the head office, for the production and employment needed to fill orders, and for overseeing production quality and the shipment of completed orders.

Third, the types of problems that were experienced by most of the garment companies were very similar, namely:

- Government bureaucratic procedures that slow the factory down with repeated requests from many different government departments and agencies to make audits and inspections for reasons that are rarely clear.
- Transportation costs – in particular unofficial payments.
- Delays in clearing both import and export shipment documents. This includes a lack of understanding on the part of the bureaucrats who do not accept required changes to the paperwork for export document. This prompts management to ask questions such as: “Who is running our businesses?”, “Who is working for whom?”, “Who is creating the exports and earning the foreign currency?”, and “What income do the bureaucrats generate?”
- Lack of a banking system.
- Labor laws that need to be brought up to-date and written unambiguously, so that all parties (management, employees, trade union officers and the Arbitration Council) have a common understanding of the various parts of the Labor Law.
- One area of major concern to garment company management is the low level of labor productivity in many of the companies, with the complaint that the workers are not motivated. Foreign managers speak of the Cambodian workers not responding to instructions and discipline requirements as they do in China and Viet Nam. There are reported to be 5,000 Chinese production supervisors working in the Cambodian garment industry, most of whom speak no Cambodian and who, it is said, have an aggressive approach to supervision of their production areas (“a stick approach rather than a carrot and stick approach”). Such an approach widens the culture gap between management and workers and it increases the language barrier between the Cambodian workers and the Chinese supervisors. These issues combined with the feeling of the female workers that in very large production areas they are not considered as individuals and so do not feel motivated. Some companies recognize the problem and are trying to address the issues, with little success so far.

Finally, when asked about the future of the Cambodian garment business, a few managers talked in terms of the strategies that they were planning for the future, but the most frequent answer was: “We are waiting to see how things turn out.” This answer is open to interpretation and may have been a way of saying: “That is our business!” or a way of saying: “I really do not have the responsibility for that issue.” Alternatively, it may be a way of saying, “We have no plans for our Cambodian-based companies.”

### Annex 3 Notes on the Macroeconomic Model<sup>57</sup>

The model used is an annual-frequency supply model, using Microsoft Excel as software support. The main feature of the model is to produce consistent economic medium and long-term forecasts, which fundamentally depend on the policies and strategies to be implemented, and the behavior of the economic agencies, in accordance with the external environment and internal political developments.

Technically, the model depends primarily on the main assumptions (exogenous variables) on the social and political environment in Cambodia, and also on the international environment as the Cambodian economy is largely an open economy. More concretely, as the model is a supply model, investment (domestic and foreign) is the key factor for Cambodia's economic development.

In general, the model's behavioral equations are econometrically estimated and fundamentally rely on the quality of the historical data. However, as the quality of statistics in Cambodia is very weak, the number of behavioral equations in the model is limited, and many are in general pre-determined.

#### **Economic Database**

While the quality of the model's underlying database is continuously under improvement, the database covers a wide range of Cambodian economic and social indicators. The database includes business accounts, some elements of household accounts, national budget, monetary survey, balance of payments, employment, and investment. Data is available from 1960 to 1970 and from 1985 to the present. Data for the period 1960 to 1970 was published by the IMF and the World Bank. The data is recompiled to be consistent with the new classification (2000 price basis) and the quality is fairly good. Data for the period 1985-93 is roughly estimated from various government sources and the quality is medium. From 1994 to the present, economic data is more readily available and the quality is relatively good. A list of the data is available on request.

**The Business Accounts** cover 22 sub-sectors, including agriculture (6 sub-sectors), industry (9 sub-sectors), and services (7 sub-sectors). For each sector there are about 20 economic variables calculated, including: (i) Supply and Demand at current prices and at 1993 prices (Production, Consumption, Investment and External trade of goods and services), (ii) Business operating accounts (value added, salary, potential contribution to the national budget, gross profit and investment), and (iii) Other accounts (employment, productivity, average monthly wages).

**The Household Accounts** cover total household revenue and monthly wages by major category of profession (rice farmers, non-rice farmers, factory workers, civil servants and others). These household accounts are compiled from the national accounts and socio-economic surveys carried out by the Cambodian Ministry of Planning.

**The Public Administration Accounts** cover the national budget operations and were compiled by the Cambodian Ministry of Economy and Finance. This data includes a large range of revenue components, expenditure by category of spending (investment, salary and other operating costs) and by major category of ministry (civil administration and defense and security), sources of deficit financing.

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<sup>57</sup> A comprehensive report explaining the model mechanism is under preparation. This EIC model is derived from the CAMPI model developed by Ministry of Economy and Finance during 1994 – 1999 and improved by CDRI during 1999 – 2002.

**The Financial Institution Accounts** are represented by the monetary surveys compiled by the National Bank of Cambodia. This data includes main monetary aggregates, such as liquidity (in riel and US\$) and credits.

**The External Accounts** reflect the balance of payments (BOP) data compiled by the IMF, the National Bank of Cambodia and EIC, based on the above business accounts (external trade and foreign investment by sub-sector). This data includes external trade, services, private income movements, foreign aid, and international capital transactions.

**Other Accounts** include the labor force and employment, and are roughly estimated from the 1998 census and various socio-economic surveys carried out by the Cambodian Ministry of Planning.

### **Economic Modeling**

The model used is a supply model, assuming general equilibrium in terms of goods and services, labor force and employment, and money supply and credit. Investment plays the most important role in the model. The main exogenous variables are twofold. The first is the international environment (foreign direct investment, foreign aid, export of garment products, number of tourists visiting Cambodia, and prices of agriculture commodities and manufacturing goods in the world markets). Second is the commitment of the Royal Cambodian Government to reforms, represented mainly by effectiveness in collecting taxes and the amount of foreign aid disbursements. The model covers thousands of variables, most of which are calculated by identity or pre-determined equations, therefore this section only deals with the general structure of the main equations. More explicit and detailed equations are available on request.

The Cambodian economy can be separated into two main categories: the traditional sector and the modern sector. The traditional sector includes mainly agriculture, handicrafts, domestic trade, real estate, and other small service industries. The modern sector developed rapidly only after the Paris peace agreement in 1991. From 1992 to 1993 most investment went to the hotel, restaurant and real estate sectors. From 1994 to 1995 some modern manufacturing and service sectors started to develop, mainly in the food industry and gasoline distribution. It is only since 1995 that the garment industry, transportation and telecommunications, and the tourism industry showed significant expansion. The economic growth of the traditional sector largely depends on population growth, while that of the modern sector is linked largely to foreign direct investment (FDI) and external demand, which are exogenous and depend on the political stability of the country and performance of the economic and institutional reforms of the Royal Cambodian Government.

For these reasons, the Production Functions of the model largely depend on investment (private and public) and past long-term trends.

- Specifically, production in the agricultural sector (excluding livestock, fishery and forestry) relies on the area of cultivable land and its productivity, which depends on past trends and the amount of new investment (private and public) in this sector. Production of livestock is linked to population growth, while production of fishery and forestry is exogenous and depends on the success of government reform policies on natural resource management.
- In the industry sector, the production of manufacturing depends on private investment and market demand (domestic and external), while the production of public utilities (electricity and water) is linked to public investment in those sectors. Production in the construction sector, both residential and non-residential, relies on investment.

- In the service sector, production of the transport and trade sectors depends on production in the agriculture (excluding forestry) and manufacturing sectors, and the level of imports of consumer goods. Production in the tourism sector (mainly hotels and restaurants) is linked to investment in these activities, while the production in the real estate and other service sectors is directly linked to population growth.
- Inflation (in riel) in the model is linked to the price of imported goods (in riel) and the trend of worker productivity. In general, Cambodia consumes domestic agricultural products, and imports manufactured goods. As Cambodia becomes more and more open, the prices of local agricultural products, particularly rice, align with world market prices. The garment industry, which represents about 70% of the manufacturing sector (in terms of nominal valued added), almost totally exports its production.
- The Exchange Rate (riel against the US\$) is technically exogenous, but in fact, depends on the level of bank financing in riel to the budget deficit in the forecast period. During past periods, one billion riel of budget deficit financed by the Central Bank resulted in a depreciation of the riel of about 10 riels per US\$.
- The money supply (in riel and in foreign currencies) is linked to nominal GDP, while credit relies on bank deposits (money supply in foreign currencies).
- The National Budget projection largely depends on economic activity trends and government fiscal policy (the official tax rate and government performance in tax collection).
- Specifically, budget revenue is linked to the amount of potential tax payments by each economic sector and the performance of the government in effectively collecting this tax. For each sector, the amount of potential tax payment is calculated by multiplying the official tax rate by the amount of value added or profits or salaries paid by the companies, depending on the categories of tax. Government performance in tax collection is represented by the ratio of the "amount of tax collected effectively from past budget data" to the above "potential tax payment". The official tax rates and government performance in tax collection are exogenous and fundamentally depend on the government's fiscal policy. For example, revision of the investment law by removing some tax incentives might raise the government performance in tax collection.
- On the expenditure side, the model separates public investment from government salaries and other operating costs. Salaries are linked to the number of public administration staff (exogenous) and the level of monthly wages that depends on the economic growth and inflation, while other government operating costs are linked to the budget revenue. The budget deficit is exogenous, and as a result, public investment is the balance between revenue, current expenditure and public deficit.
- The Balance of Payments projection depends on external trade and the exchange of services of each sector. Foreign aid and foreign direct investment (the main components of the capital accounts) are exogenous and rely on government success in implementing reform policies. Since 1999, donors have generally linked their assistance to the performance of the government in terms of reforms. In addition, as the Cambodian economy is strongly dollarized, the private sector (business and households) freely owns foreign currencies. For this reason, the balance of payments in the model also considers the foreign currencies owned by both the Central Bank and the private sectors. With regard to trade, the import of goods depends directly on the demands of each sub-sector (intermediate consumption, final consumption and investment), while exports are the

balance between supply and domestic demand. Activities in the service sectors mainly depend on the volume of foreign tourism.

- Investment includes four components. As stated above, private foreign investment and public investment financed by foreign aid are exogenous. However, public investment financed by domestic revenue is calculated in the national budget section as the balance between government revenue and current expenditure, while private investment domestically financed is calculated for each sub-sector in the business account section and mainly depends on profits accumulated during the previous three years.
- Employment in each sub-sector is directly calculated from the level of valued added at constant prices and worker productivity, which is determined by past trends. The workforce in Cambodia is very under-employed, especially in the informal economy. The productivity of workers therefore fluctuates greatly.
- Wages of workers are also directly derived from worker productivity and inflation rates.

## **Annex 4**

### **Note on the Government-Private Sector Forum**

The International Finance Corporation (IFC) has supported the Government-Private Sector Forum (GPSF) since its foundation in early 2000 as a mechanism to improve the business environment, build trust between the public and private sectors, and foster private investment activity.

The GPSF provides the framework for ongoing, structured dialogue between business and the Royal Cambodian Government with the goal of improving the business environment. The Prime Minister chairs a large meeting attended by private business leaders, the donor community, and government officials, usually held twice a year. However, the basic work is undertaken during the year by seven public-private working groups that specialize in areas ranging from agro-processing to financial services, law and tax, governance, to tourism among others. The IFC and Australian Agency for International Development (AusAID) financially support the Government-Private Sector Forum Coordinating Bureau.

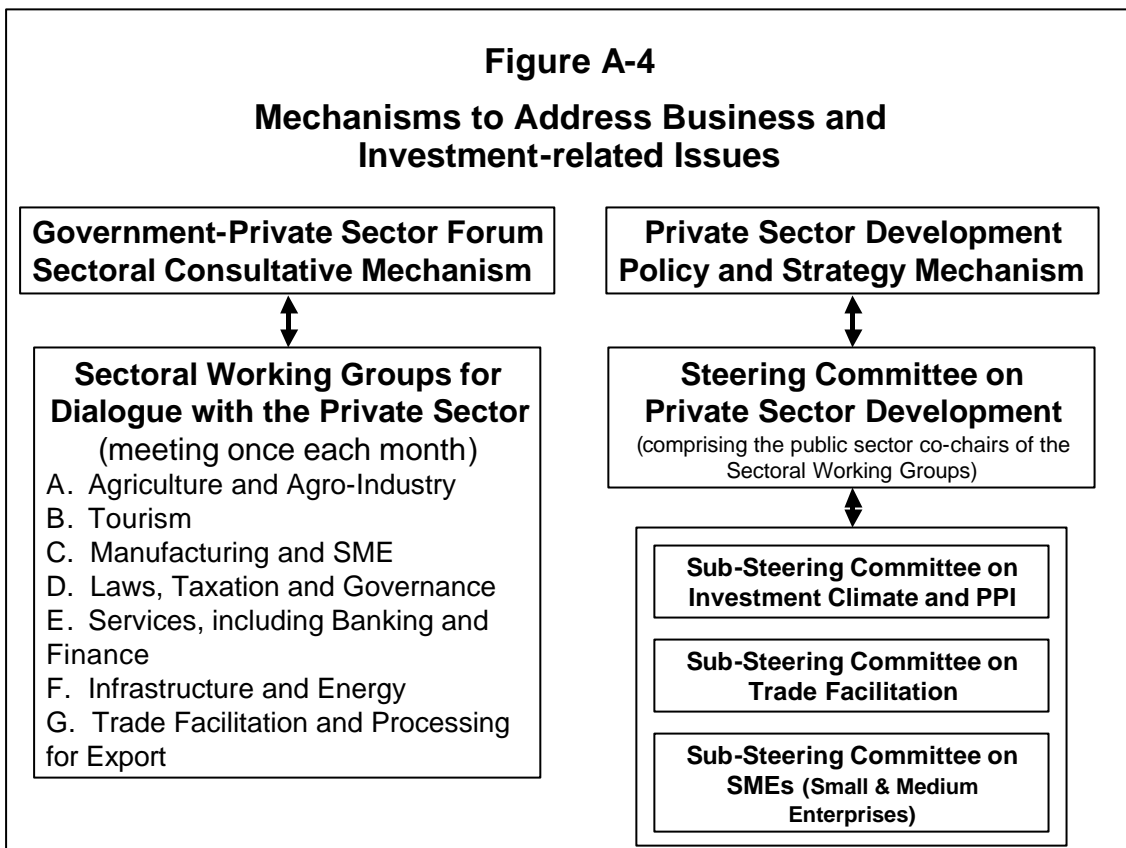
Despite its short history, the concept of the GPSF and public-private dialogue is proving durable in Cambodia. The GPSF has demonstrated its ability to serve as an unbiased intermediary between the private sector, the Royal Cambodian Government, and the donor community in a market that generally lacks organized associations and business groups capable of serving as independent forces for change.

The GPSF has provided a platform for business leaders to offer expertise on a range of policy and regulatory reforms. Successful examples include high-level consultation on investment and tax law, the introduction of private sector monitors within the Customs Department, and negotiations on cost reductions in the contract for a major road concession. The working group on tourism was invited to develop an action plan to attract more Chinese tourists to Cambodia in advance of the Prime Minister's visit to China in April 2004. This led to plans to open tourism offices in selected southern Chinese provinces.

In facing the challenge of creating an environment of trust, while rebuilding the legal and regulatory systems, the GPSF continues to generate interest in all sectors for the promotion of dialogue and action aimed at tackling economic development challenges through the private sector.

On 26 July 2004, the Private Sector Development Policy and Strategy Mechanism was formed as a new mechanism to further strengthen the capacity of the Royal Cambodian Government to implement reforms to facilitate business and private investment activities in four areas. These are (a) trade facilitation, (b) promotion of market infrastructure and deregulation, (c) enhancing market access and access to information, and (d) promotion of small and medium enterprises. A Steering Committee on Private Sector Development was formed comprised of all key ministers to propose and implement all the reform measures. Three Sub-Steering Committees support the Steering Committee. These are (a) Investment Promotion and Private Participation in Infrastructure (PPI), (b) Trade Facilitation, and (c) SMEs. These three Sub-Steering Committees work closely with all development partners to coordinate development assistance and ensure efficiency of donor programs.

In his speech announcing the new mechanism (see Hun Sen, 2004), the Prime Minister stressed that: "the seven Working Groups are a Sectoral Consultative Mechanism within the Government-Private Sector Forum, which was initiated during the last mandate, while the Steering Committee and its three Sub-Steering Committees are new mechanisms created to assist the Royal Government to set, lead and monitor the implementation of policies, strategies and action plans for the Royal Government which aims at promoting the development of the private sector, including playing the role of focal point for the Royal



Government to coordinate work with development partners. The two mechanisms are closely interrelated, as the co-chairpersons of the seven Working Groups from the government are members of the Steering Committee for Private Sector Development. On the other hand, through the seven Working Groups the private sector partners are able to actively, positively and constructively participate in the formulation of action plans and monitor the implementation of the Royal Government's Private Sector Development Strategy."

These two complementary mechanisms provide a vehicle for the Royal Cambodian Government to address the challenges faced by the garment industry as the ending of quotas draws near and the pressure on the garment industry to enhance competitiveness increases. In particular, the Sub-Steering Committee on Trade Facilitation and the Working Group on Trade Facilitation and Processing for Export focus strongly on issues of relevance to the garment sector. In the longer term, all three Sub-Steering Committees address the range of multi-sectoral issues that is required to lay the foundations for a stronger garment sector in the future.

**Annex 5**  
**Notes on the Roles of Business Associations**

There have been extensive recent discussions about the role of business associations in economic development in general (see Donor, Richard and Schneider, Ben Ross, Business Associations and Economic Development, Processed Report, July 2000) and in the Greater Mekong Subregion (GMS) in particular (see Brimble, Peter, Business Associations and the Asian Crisis: An Action Agenda for the GMS, presented to the Symposium on the Comprehensive Development of the Greater Mekong Subregion under the Forum for the Comprehensive Development of Indo-China (FCDI), Bangkok, April, 1999). The following table, derived from the two sources cited above, presents an indicative listing of the types of activities that can be carried out by business associations under two categories: (a) market enhancing; and (b) market complementing.

<p><b>A. Market Enhancing Activities of Business Associations</b></p> <p>Market enhancing activities indirectly support the functioning of the market. These include a range of activities, from lobbying for improved property rights and regulatory frameworks, to pressuring the public sector to address critical infrastructure shortages. Another element concerns “civil society: the role that business associations can play in bringing concerted pressure on governments to strive for higher levels of transparency and accountability in the entire range of government interventions/regulations governing the private sector development environment”.</p>	
<p><b>B. Market Complementing Functions of Business Associations</b></p> <p>Market complementing activities cover the wide range of activities that business associations can undertake to strengthen the capacities of their members and to overcome various types of market failures. The table below provides a comprehensive listing of these activities, which work to harness the critical mass of a business association (i.e. the power of collective action) to provide a range of services and standards that no individual company would be able or willing to carry out on alone.</p>	
Functions	Illustrative Examples
<p><b>1. Macroeconomic Stabilization and Reform</b></p>	<ul style="list-style-type: none"> <li>• Business participation in agreements to limit wage and price increases in Mexico to support efforts to bring down inflation</li> <li>• Large-scale business support/participation in Chile with regard to responses to the macroeconomic crisis in the 1980s</li> </ul>
<p><b>2. Horizontal Coordination</b> (quota allocation, capacity reduction)</p>	<ul style="list-style-type: none"> <li>• The involvement of the Turkish Clothing Manufacturers Association in making the allocation of textile quotas more impartial and linked to performance</li> <li>• The Taiwan Footwear Manufacturers Association working to upgrade industry efficiency through improved quota allocations</li> <li>• The Thai Textile Manufacturers’ Association role in forging association-wide agreements combining capacity reduction with export incentives</li> <li>• The Korean Federation of Textile Industries activities to combine influence over capacity with a modernization program for the industry</li> </ul>

Functions	Illustrative Examples
<b>3. Vertical Coordination</b> (upstream – downstream linkages)	<ul style="list-style-type: none"> <li>• The Thai Sugar Association's role in brokering an agreement on prices for raw sugar which prevented disruption of sugar exports</li> <li>• The Taiwan Footwear Manufacturers' Association's agreement with upstream plastic material producers to allow them to pass on price and quality concerns in order to ensure a satisfactory and continuous supply of raw materials</li> <li>• Numerous examples of industry groups in Brazil, Korea, Taiwan, Mexico, etc., that supported efforts to put in place rational tariff structures conducive to the development of the overall industry value-chain</li> </ul>
<b>4. Information Provision</b>	<ul style="list-style-type: none"> <li>• The Chinese Chamber of Commerce in Penang's provision of information to multinational semiconductor firms on SME suppliers</li> <li>• Korean Associations' efforts to "socialize costs of information about export markets" which greatly assisted the Korean export drive</li> <li>• The Thai Textile Manufacturers' Association's program to provide information to its members about European markets and related promotional activities during the textile market downturn in the mid-1970s</li> </ul>
<b>5. Standards</b>	<ul style="list-style-type: none"> <li>• Thailand Board of Trade's efforts to ensure that its members adhered to international rice product standards in the 1950s</li> <li>• The Aruaru Association of Furniture Makers initiative to set product standards and guarantee the warranties of exporting member companies</li> <li>• The Taiwanese Electrical Appliance Manufacturers' Association's development of a quality control agreement among their members to "protect their reputation in the international market"</li> </ul>
<b>6. Skills and Technology</b>	<ul style="list-style-type: none"> <li>• The Malaysian Auto Parts Manufacturers' Association program to disseminate information on best practices in management and specific technologies</li> <li>• The very recent involvement of business associations in Thailand in meetings with government officials to explicitly address technology and skill problems</li> <li>• The establishment of technical training institutions and a technology center by local producers and suppliers in Brazil's Sinos Valley, initiatives that enhanced the industry's ability to respond to export opportunities in the 1970s</li> </ul>

## **Annex 6**

### **Profile of Pilot Project 1: Garment Employee Development**

#### **1. Introduction**

Based on the findings of the investigative phase of the TA Project, a comprehensive Garment Employee Development Pilot Project, aimed at strengthening the productivity and personal situation of garment industry employees, has been designed for implementation during September-December 2004.

#### **2. The Pilot Project**

The pilot project has four components to assist the Cambodian garment industry in attaining a niche market position in the international market by achieving higher labor productivity, and to improve the personal situations of garment industry employees. The components have been identified on the basis of the findings of the TA Project investigative phase, and consultations with MOC, MOWA, MOLVT, garment workers and other development partners among the NGOs, and multi-lateral and bilateral donors.

The four components are:

- Skill Development Programs to Improve the Productivity of Garment Industry Employees
- Empowering Employees to Ensure Social Security and Skill Development for Alternate Employment and in Non-Garment Industry Sectors
- Improvement of HR Conditions of Employees
- Knowledge Management

#### **2.1 Background**

The largely young, female, disciplined workforce from poor rural and urban households is the backbone of the garment industry in Cambodia and has contributed significantly to Cambodia's impressive growth in garment exports over the past decade. Existing literature and a comprehensive socio-economic survey profiling garment industry employees conducted during the investigative phase<sup>58</sup>, shows that:

- Most employees have no education or do not complete primary school; only a small percentage have access to secondary school education and above; often, young men and women migrate in groups and have relatives and neighbors from the same village employed in garment factories. The main reason for migrating to the city for work is shortage of food, in spite of a family owning land and other assets. Research indicates that this is because a significant percentage of Cambodia farmers, who previously had a reasonably secure life, are moving towards insecurity due to a number of factors that have made agricultural production uncertain from year to year.
- The total salary received by garment industry employees varies considerably depending on a number of factors, particularly job status – permanent, trainee or temporary - and amount of overtime work. Almost 90% of the garment industry employees in the survey remitted a significant part of their salary to family every month. Remittances amount typically to about US\$20-US\$40 per month.

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<sup>58</sup> The Cambodian Researchers for Development (CRD) carried out the survey of 1,538 employees in and around Phnom Penh from December 2003 – January 2004.

- There is limited awareness of the labor laws; garment industry employees are more concerned about factory rules. Health and safety issues are a key concern of garment industry employees and medical expenditure accounts for a significant part of the earnings.
- Cultural gaps with management were also a cause for concern; and while employment in the sector was an immediate economic need, it was not the long-term choice of over 50% of the employees surveyed. There was a strong desire expressed by many garment industry employees to return to their villages after a few years or to start a small business or shop.

## 2.2 Objectives of the Pilot

The overall objective is to identify and implement at the pilot level appropriate measures to retain and strengthen the relatively impressive record of the garment industry with regard to compliance with labor requirements by the importing countries by:

- (a) Improving the productivity of workers so that the garment industry can compete at the international level and continue to achieve a substantial share of the market in the post quota era from January 2005
- (b) Developing capacity for employment outside the garment sector and minimizing the impact on poverty levels as a result of any possible decrease in jobs; and in response to the personal goals of a significant number of garment industry employees for alternate employment
- (c) Improving the personal situation and motivational levels of garment industry employees
- (d) Enhancing the participation of NGOs and the private sector in improving the lives of garment industry employees and development of the garment sector.

## 2.3 Strategy for the Pilot

Following are the core principles underlying the design and implementation of the pilot:

1. To choose and formulate actions that are likely to have the greatest impact on reducing poverty and improving the productivity and lives of garment industry employees.
2. To ensure that the strategy for the Pilot Project is in line with Cambodia's Gender and Poverty strategy, and supported by and in line with ADB overall pro poor strategies<sup>59</sup>.
3. To supplement the TA Pilot Project resources with contributions from key stakeholders in the industry - factory owners, GMAC, MOC, and other interested donors.
4. To provide services and skill development opportunities on a demand and cost sharing basis – by factory owners and employees. Skill development programs will all be implemented with no gender discrimination.
5. To identify policy reform risks for the workers through the knowledge management initiative.
6. To build capacity among garment employees, managers and relevant ministries to address identified issues.

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<sup>59</sup> Cambodia Gender Assessment, Mainstreaming Gender in the NPRS and CMDGs, prepared collaboratively by ADB, UNDP, UNIFEM and the World Bank, Cambodia. Also the Participatory Poverty Assessment: Cambodia, ADB, December 2001.

## **2.4 Components of the Pilot**

### **2.4.1 Skill Development Programs to Improve Productivity of Garment Industry Employees**

One of the major areas identified for action, if Cambodia is to retain its advantageous position in the international market, is to improve labor productivity that is presently lower than competing countries like China, Viet Nam and Bangladesh. Therefore the skill development program is critical to demonstrate its impact on productivity. Improved skills are also likely to motivate garment industry employees to achieve higher productivity levels.

It is proposed to have two streams of skill development programs, taking into consideration first the need to improve labor productivity and second, to respond to the overwhelming desire of garment industry employees for alternate sources of income, evidenced by the SESGEC.

- (i) Training at entry
- (ii) Upgrade skills (new product development/modernization)
- (iii) Training of instructors
- (iv) Life skills training for garment industry employees

### **2.4.2 Empower Garment Industry Employees to Ensure Social Security and Skill Development for Alternate Employment and in Non-Garment Sectors**

It is proposed to involve the NGO, PADEK, extensively in implementation of the programs for social safeguard mechanisms by establishing Self Help Groups (SHG) and in implementing the programs for skill development for alternate employment. PADEK supported activities are designed to provide a safety net for garment industry employees along the pattern established by PADEK in the three provinces where this NGO operates. In addition, program components will include: skill development training related to non-garment sectors, such as training for entry into growth sectors, and an entrepreneur development program providing assistance in setting up small businesses, etc.

### **2.4.3 Improve HR Conditions of Garment Industry Employees**

- (i) Familiarization programs for management (particularly HR managers); seminars on labor laws, arbitration etc.
- (ii) Familiarization programs for garment industry employees on work ethics

One of the criticisms regarding the productivity level of garment industry workers in Cambodia has been that work ethics could be improved. Since a large percentage of garment industry employees come from poor rural backgrounds with limited education and exposure to assembly line manufacturing, they do not recognize the value of following strict work schedules. Garment factory managers felt that often their employees are unwilling to work extra hours and extra hard because they feel that this only adds to the earnings of the “rich overseas” factory owner.

#### **2.4.4 Knowledge Management**

The TA Pilot Project team sees an opportunity to contribute to knowledge on the impact of trade on women in Cambodia at the national level. Recent literature on macro economic analysis has recognized that greater exposure to the world economy has uneven effects on men and women in developing countries and these are imperfectly understood<sup>60</sup>. The authors have modeled such effects using data from Bangladesh, another key player in the garment sector and propose to attempt to do similar analysis in collaboration with the University of Sussex, UK.

### **3. Institutional and Implementation Arrangements**

The Pilot Project will be implemented by the Cambodian Ministry of Women's Affairs (MOWVA), with support from the Cambodian Ministry of Commerce (MOC), the executing agency for the TA Pilot Project, and in coordination with the Cambodian Ministry of Labor (MOLVT). Coordination with other stakeholders, particularly ILO, will be maintained throughout implementation of the Pilot Project.

### **4. Monitoring and Evaluation**

Monitoring the activities and evaluating the results, to the extent feasible, will be critical for documenting the lessons from the Pilot. The pilot activities will be monitored by MOWVA with the support of a Coordinator and an international GSD Specialist. The following tools will be used as necessary:

- Beneficiary surveys of the participants in the various training activities and seminars
- Participatory group discussions with garment industry employees, managers, etc., to support the assessment of differences in the quality of output and productivity of garment industry employees that have undergone training.
- Tracer study of garment industry employees who undergo non-garment sector training (in particular the entrepreneur development program) and who are subsequently employed in other growth sectors or establish small businesses of their own.
- Process documentation, i.e. examination of the processes involved in implementation of various activities, the time and resources taken, and the nature of overall outcomes as a result of the pilot, will be used to learn from the implementation experiences.

### **5. Time Frame**

The pilot will be implemented over a period of four months from 1 September to 31 December 2004.

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<sup>60</sup> Marzia Fontana and Adrian Wood, *Modeling the Effects of Trade on Women, at Work and at Home*, World Development Vol. 28. No. 7, pp. 1173-1190, 2000.

## **Annex 7**

### **Profile of Pilot Project 2: Labor Law Analysis**

#### **1. Introduction**

In the area of labor and employment law, a Labor Law was enacted in 1997. The Law defines the rules relative to collective bargaining, employment termination, mandatory employee benefits, safety standards, and employment dispute resolution. Since the Labor Law took effect there remain ambiguities and inconsistencies that have led to bitter industrial relations disputes and some violent and fatal incidents.

Moreover, considering the emerging state of the rule of law concept in Cambodian society and the extremely weak legal and judicial framework, garment industry employers and employees are often not fully aware of their rights and obligations under the law. Women, who comprise the majority of the work force in Cambodia, are particularly vulnerable in that regard. Thus, the education and training of both garment industry employees and employers is critical, both for promoting better understanding of the rule of law in the workplace and for long-term economic growth.

#### **2. The Pilot Project**

The comprehensive pilot project on Labor Law Analysis is addressing the legal framework of the labor and industrial relations affecting the garment industry and increasing the ability of garment industry stakeholders to operate with greater certainty as regards workers' rights and obligations under the Labor Law.

The following four components of the pilot project were developed based on the ongoing needs of the garment sector and consultations with MOC, Cambodian Ministry of Labor, GMAC, labor unions, and garment industry workers:

- Component I: Legal Analysis;
- Component II: Materials Update and Development;
- Component III: Capacity Building; and
- Component IV: Outreach to Provincial Stakeholders.

#### **3. Strategy of the Pilot**

Following are the core principles underlying the design and implementation of the pilot:

1. To choose and formulate actions that have the greatest impact on reducing the uncertainty regarding the interpretation and enforcement of the Labor Law, on improving the stability of labor and industrial relations, and on promoting better understanding of the rights and obligations of garment industry employees.
2. To be in line with the Royal Cambodian Government's policy of linking garment exports and the respect of labor law as specified in the US-Cambodia Textiles Agreement, and as promoted under the "Cambodia as a Safe Sourcing Nation" branding strategy in the post-quota era.
3. To build upon and reinforce existing synergies with other organizations with a role in the garment sector such as the International Labor Organization (ILO), Labor Arbitration Council (LAC), Cambodian Investment Board, and GMAC (the industry association).
4. Provide legal resources and tools for sector stakeholders through a transparent and readily accessible source of easy-to-understand legal material.

5. Contribute to the capacity development of labor unions, garment factory owners/workers on the Labor Law.

#### **4. Objectives of the Pilot**

The principal objectives of the pilot are to (i) assist the Royal Cambodian Government to further develop observance of the Labor Law through the production of training material on Cambodia's Labor Law and regulations, and (ii) provide training to the major target audiences in these laws and regulations.

The expected principal output of the component are as follows: (i) analysis of the Labor Law and regulations in light of experiences and compliance issues in the garment industry over the last 5 years; (ii) provision of a series of recommendations for awareness building, clarification and possible amendments to the Labor Law; (iii) updating and consolidating the compendium of the Labor Law and regulations and other implementing rules, including related decisions of the Labor Arbitration Council relating to labor disputes; (iv) production of training pamphlets and materials as required on Cambodia's Labor Law and regulations to raise awareness among both employers and employees; (v) training of ministry officials, labor inspectors, labor arbitrators, vocational training center managers, employers, employees (with emphasis on women workers, disabled workers, and union leaders); (vi) training of future instructors; and (vii) dissemination of these materials to other industry stakeholders in other parts of the country with garment industries.

#### **5. Components of the Pilot**

The pilot includes four key complementary components to achieve the objectives.

##### **5.1 Component I: Legal Analysis**

- (i) Analysis of the Labor Law and its implementing regulations in light of the experiences and compliance issues in the garment industry over the last 5 years. The existence of ambiguities in the law that have resulted in various labor disputes will be given special attention
- (ii) Provide a series of recommendations on areas of the Labor Law found to be ambiguous, for eventual clarification and possible amendment.

##### **5.2 Component II: Materials Update and Development**

- (iii) Updating and consolidating the compendium of the Labor Law and regulations and other implementing rules, including the decisions of the newly established Labor Arbitration Council (LAC) relating to labor disputes. These texts will be prepared in a uniform format suitable for both publishing and for public use through the web page of the MOC or of the Cambodian Ministry of Labor.
- (iv) Incorporating the latest developments in the Labor Law into the production of a textbook (Examples and Explanations Series), training pamphlets and materials, and printed and audio-visual format (Video and CD ROM) in both the English and Khmer languages, with a special focus on women, to support the education and training of target audiences.

### **5.3 Component III: Capacity Building**

- (v) Updating and training of government officials from Cambodian Ministry of Commerce, the Cambodian Ministry of Labor, Cambodian Ministry of Women's and Veteran Affairs (MOWVA), and the Labor Arbitration Council, on the Labor Law and related employment regulations;
- (vi) Updating and training of garment industry employers, union leaders, and men and women workers in Labor Law and related employment regulations;
- (vii) Training of prospective instructors identified during (the above mentioned) training sessions as individuals excelling in understanding the materials, to create sustainability and permit training activities to continue after completion of the Pilot Project.

### **5.4 Component IV: Outreach to Provincial Stakeholders**

- (viii) Develop simple outreach activities to other provinces where garment industries exist in order to implement activities as identified above.

## **6. Institutional and Implementation Arrangements**

The Cambodian Ministry of Commerce is implementing the Pilot Project with support from the Cambodian Ministry of Labor, and in close collaboration with the major stakeholders, i.e. the trade unions, garment industry employers (GMAC), and ILO.

The Pilot Project will be implemented over a period of four months from 1 September to 31 December 2004, with an inception report being prepared by early October 2004.