# ANNEX 2:
# Impacts, Opportunities, and Challenges of the Global Economic Downturn on Cambodia

The global financial crisis started early 2008 and has had the impact on countries in the entire world. The phenomenon slows down economic growth and drives millions unemployed around the world. Like other countries, Cambodia has suffered from the crisis, which not only undermines its macroeconomic performance, but also has a genuine negative social impact and worsens poverty. The crisis affects the four main pillars of Cambodia's economy (garment, construction, tourism, and agriculture), as they are connected to the global economic via foreign director investment and export market. The impact is severe in the labour market, which causes unemployment and underemployment leading to reductions in household income driving people less better-off and into deeper poverty. The current economic crisis is an obstacle to achieving Cambodia Millennium Development Goals by 2015.

## Impacts on Economy and Labour Market are severe

In the last five years, Cambodia enjoyed its high GDP growth rate averaging around 11% per annum[1]. Within the circumstance of the global financial crisis, textile and clothing, construction, and tourism are most fragile due to their high dependency on both foreign investment and export markets[2]. In January 2009, Cambodian garment export were approximately 60% lower than January 2008, according to IMF March 2009. As a result, about 70 factories[3] have closed their operation since the crisis started early 2008 while some garment factories have cut off their production. Consequently, more than 50,000 garment workers are laid off[4] and the reduced production results in less working hours and over-times, which cause the average wage of garment workers to decline. The job loss in garment sector may have a ripple effect on other jobs as this sector provided 242,000 indirect jobs in addition to 270,000 jobs it directly created[5]. The investment in construction has also dropped since second quarter of 2008. Like garment industry, the slowdown in construction results in 15,000 jobs lost[6].

## Less Government Effort possible due to declining revenues

In overall, the global economic crisis has had the impacts on Cambodia's economy as a whole. It results in declined investment and exports/imports, less economic activities, and unemployment and underemployment, which further leads to the loss in national revenues, especially from customs and excise tax, income and profit tax, and VAT. This reduces the ability of the Royal Government to address the negative impact through increased public spending. Fortunately, at the 2nd CDCF (Dec 2008), Cambodia received a significant amount of aid as pledged from its development

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[1] Powerpoint Presentation made by HE Hang Chuon Naron, Secretary General of Ministry of Economic and Finance, at Oil and Gas Youth Forum: Impact of Global Economic Crisis on Oil and Gas Extraction in Cambodia (23 March 2009, organized by YRDP)

[2] CIDS (Jan 2009). Rapid Assessment on the Impact of the Financial Crisis in Cambodia

[3] & [4] Poweverpoint Presentation made by HE Cham Brasidh, Senior Minister, Minister of Commerce, at the 2009 Cambodia Outlook Conference (12th March 2009, Phnom Penh Hotel)

[5] Vuthy C., and Hach, S. (EIC, Jan 2007). Cambodia's Garment Industry Post-ATC – Human Development Impact Assessment

[6] CIDS, Rapid assessment on the impact of the financial crisis in Cambodia, January 2009

partners, which is approximately US$1,000 million for 2009. This would potentially serve to complement the government effort to address the issue.

**Job losses are a threat on gains made in poverty reduction**

A large majority of workers in garment, construction, and other sectors are migrants from rural Cambodia. They usually send money home to help their families (90% of them). According to the study of CDRI [7], as supplement to low income of their family in rural areas, the remittances are used to support their families for the whole year to buy food and productive assets, pay for children's education, family health services, repayment of debts etc.

The loss of jobs and less wage of workers in these sectors definitely means the household has less income to cover their expenditure. Similar to circumstance of inflation, people are likely to cut off non-essential spending such as education and health or they may choose to eat less or less nutritious food, which further leaving them to become more vulnerable to illnesses. This explains that as the income of households reduces, some are pushed below the poverty line or the already poor experience deeper chronic poverty.

**Challenges in rubber and cassava, opportunities in rice**

Agriculture crops are less vulnerable to the crisis than other main sectors in the economy, proved by recent research of CIDS (Jan 2009). However, some agricultural commodities, especially ones that are largely dependent on export markets (for example, rubber and cassava), tend to be hit hard by the crisis. CDRI statistics confirmed that, in November 2008, the price of rubber and cassava dropped by half compared to the same month in 2007. This explains some loss in export of agriculture products. Nevertheless, the price of paddy rice after the crisis (November 2008) was still more than 10% higher than it was before the crisis (November 2007)[8], when the price was already fuelled up. The export value of rice increased from US$ 634 million before the crisis to US$ 705 million after the crisis[9]. There is evidence that the price of rice will even go up and thus provide high return on investment in agriculture. While FAO predicts that food crisis will continue over the next ten years, Paul Krugman (a Nobel Laureate) says food crisis will return when economic crisis fades. This clearly shows the potential for developing agriculture sector that is labour-intensive and that there are rooms to increase production and productivity when agriculture infrastructure develops.

However, again, there remain challenges. Cambodia's agriculture is rain-fed and very susceptible to floods, droughts, and pests. Farmers can usually harvest one crop per year and the productivity is still low (2.2 tons per hectare[10]) compared to neighbouring countries which share similar agro-climatic conditions. On the other hand, many farmers do not have access to land for their production. Of the rural households, 46% of them are landless and land-poor[11]. Moreover, the level of public investment allocation to MAFF and MoRD has never reached the NSDP allocation (10% each). Despite being under-funded, both ministries have never been able to

[7] CDRI, Cambodia Development Review, Volume12, October-December 2008

[8] Powerpoint Presentation made by Then Vuthy, CDRI, at 2009 Cambodia Outlook Conference (12th March 2009, Phnom Penh Hotel)

[9] Powerpoint Presentation made by Then Vuthy, CDRI, at 2009 Cambodia Outlook Conference (12th March 2009, Phnom Penh Hotel)

[10] MoP (2008). NSDP 2006-10 MTR report.

[11] WB (2006). Cambodia: Halving poverty by 2015? Poverty Assessment 2006

spend their allocated capital budgets[12]. The MAFF spent 84% in 2006, 50% in 2007, and 25% in 2008 of its respective capital budget. The MoRD, on the other hand, spent 81% in 2006, 74% in 2007, and 32% in 2008 of its respective capital budget.

**WAY FORWARD: Invest in rural infrastructure and social safety nets**

We recognize that the global economic crisis has a significant impact on Cambodia's economy and undermines the government ability to collect its fiscal revenue. Therefore, the intervention to the crisis requires close collaboration from the donor community under good leadership and coordination from the Royal Government.

Past experience in public expenditure shows that 35% of the capital budget was spent in Infrastructure sector in 2007 while the investment budget for MAFF and MoRD have always been under-funded and even under-spent over past three years. Further, the share of the government's recurrent budget which is not clearly allocated was 17.2% in 2009 compared to 5.6% in 2004[13].

We believe that the current crisis is the right time to break with the patterns of public spending of the past and prioritize investments that are labour intensive and benefit rural development. With existing Government resources and additional resources available from the 2009 aid pledge this should well be possible. As such, we suggest the Royal Government and donor community to consider as following:

- Direct public investment to rural infrastructure, especially rural roads and small- and medium-sized irrigation systems. This has two benefits:
    - This labour intensive investment creates employment that can compensate for the loss of jobs in construction, tourism, and garment industry and generates income thereby facilitating economic activities.
    - Over a longer run, rural infrastructure will reduce vulnerability for Cambodia's agriculture as a whole, and increase agricultural outputs and productivity that will eventually enhance domestic food security and boost up export.
- While more public investment resources need to be made available to agriculture and rural development sectors to reach the level that indicated in the NSDP Mid Term Review, the Royal Government and donor community should manage to solve the issue of under-expenditure that has characterised the two sectors.
- Increasing and improving targeting of social safety expenditure is of urgent measure to protect the poor and vulnerable groups. Therefore, quickly identifying groups that suffer most from the crisis and reviewing the existing social safety net mechanisms and programs would allow effective intervention.

[12] For more details, see annex 3 of the GDCC statement on the 2009 Budget Law.
[13] Line items "Precautionary expenses" plus "other expenses" as reported under chapter 99 in the Budget Law.

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