Impact of the Global Financial Crisis on Cambodia's Trade and Investment Sectors

This article summarises the presentation by H.E. Dr Cham Prasidh[1] during session 1 of the 2009 Cambodia Outlook Conference.

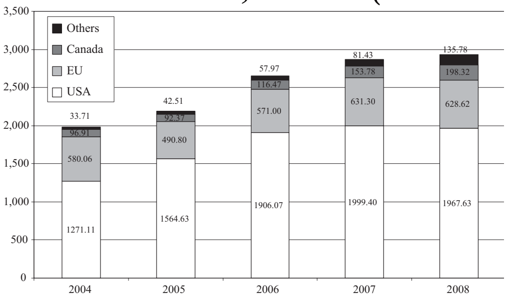
Is the Cambodian economy insulated from external shocks? Not at all. Its growth pillars—garments, tourism, construction and agriculture – are more or less vulnerable to outside shocks. This has been demonstrated in the present crisis, which brought global growth to a halt, pushed advanced economies into deep recession, discouraged industrial production and exports and reduced confidence to historic lows. The downward revisions in IMF growth projections signal the heightened severity of the crisis. Rather dramatically, the IMF estimate for Cambodian growth in 2009 was downgraded from 4.8 percent to a negative 0.5 percent. Growth is expected to bounce back to 3 percent in 2010.

Impact on the Garment Sector

The crisis gave evidence of the vulnerability of Cambodia's growth sectors to external meltdowns. Consider the slowdown suffered so far by the garment industry, the country's leading export sector. Garments are about 65 percent of the country's total exports, based on recent trends. The slowdown in this sector has been extraordinarily sharp and is ultimately attributable to the lack of diversification in garment export markets and products. After growing 21 percent in 2006, garment export values grew by only 8 percent and 3.3 percent in 2007 and 2008 respectively. More recent data indicate that the situation has turned for the worse. Monthly garment export values fell alarmingly to USD165 million in January 2009 and USD102 million in February, after averaging about USD200 million in 2008. The contraction has followed the steep drop in US retail sales. Based on recent figures, about 65 to 70 percent of Cambodian garment exports go to the US on average. Unsurprisingly, the recession and ensuing lower import demand from the US had significant knock-on effects on this sector.

The concentration of most garment activities in the lower end of the value chain further prevented

Figure 1: Cambodia's Textile and Garment Exports to Various Markets, 2004–08 *(Value in US$ million)*



Source: MOC March 6, 2009

spreading the risks from the current crisis. The ordeals faced by foreign investors supplemented the blow to the FDI-dependent garment industry. All these unfavourable developments have had direct implications for garment factory operations and employment. The total number of active factories fell from 292 at the end of 2008 to 277 only two months later. The figures also show the number of garment workers peaking at 352,000 in September 2008 and then falling to 301,000 in February 2009, reflecting 51,000 job losses. Apart from lay-offs, an increase in underemployment has been another consequence of garment factories trying to reduce their operating costs. A deceleration in footwear exports has also been reported, their annual growth dropping from 42.6 percent in 2007 to 4.8 percent in 2008. The European Union has received the lion's share of such exports.

Impact on Tourism and Construction

Tourism is still growing, although at a considerably slower rate. The number of tourist arrivals in the country passed the 2 millionth mark in 2007 and reached 2.1 million in 2008. However, the sector's growth plunged from an average of 25 percent to 5 percent in 2008 (Figure 3).

Construction activities have likewise visibly decreased. In 2008, construction approvals were down 40 percent. This can be attributed to the slowdown in foreign direct investment, on which the recent outstanding growth of the Cambodian economy was anchored. FDI represented almost 60 percent of total investments for the period 2004 to 2008. Regrettably, IMF balance of payments data indicate that the amount of FDI receded from an estimated USD866 million in 2006 to an

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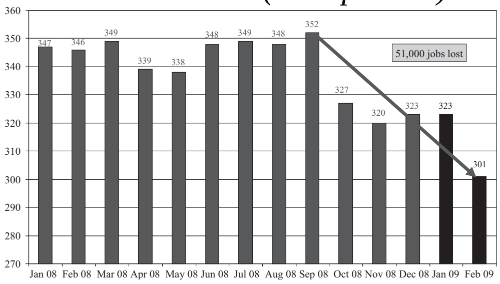
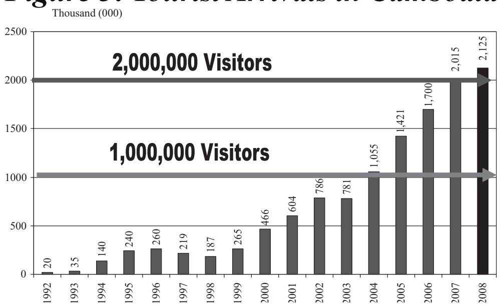
Figure 2: Employment in the Garment Sector, Jan 2008–Feb 2009 *(1000 persons)*



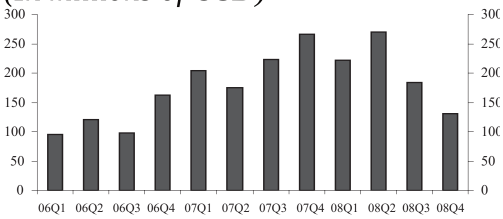
Source: MOC March 6, 2009

Figure 3: Tourist Arrivals in Cambodia



Source: Ministry of Tourism

Figure 4: Foreign Direct Investment, Net *(In millions of USD)*



Source: NBC's quarterly BoP

estimated USD785 million in 2008. Data from the National Bank of Cambodia depict a decline in FDI in the final two quarters of 2008. In total, the IMF projects FDI to fall sharply to USD488 million this year. Investments from South Korea have stalled in particular, due to the severe credit crunch in that country. Nevertheless, South Korean investors' confidence in the Cambodian economy remains high, and small and medium projects are still coming.

Outlook and Potential Responses

As mentioned, the 2009 outlook for Cambodia has worsened, the IMF downgrading this year's predicted growth to -0.5 percent. There is a possibility of the economy falling into recession. A slight recovery is foreseen for 2010, but risks continue on the downside. To stave off a likely recession, all parties need to exercise vigilance, and the government needs to deepen its reforms. Government measures so far, including the 1 percent advance profit tax exemption, have been useful and commendable, but a lot remains to be done. We must resist protectionist policies. During these difficult times, it is tempting to erect trade barriers to protect one's economy, even to the detriment of everbody else's. A more appropriate solution lies in greater trade openness and integration.

For Cambodia, redirecting more trade to the region will be lucrative because then the risks will be spread more and trade costs can be brought down. It is important, however, that greater market integration, at the global or regional level, be complemented by a strategy of enhancing the country's competitiveness and further diversifying its markets and products. Recognising the resource limitations of the government, Aid for Trade is a scheme that can help the government fund the necesary infrastructure to be able to exploit trade opportunities. Bank financing is another alternative funding source, and export credit can very well save exporters affected by the crisis and reinforce overall trade. Already an often cited solution, market diversification is a must that need not be stressed further. Non-traditional markets must be explored. Deepening trade facilitation reforms to bolster competitiveness is another measure that deserves the help of all concerned. Further investment in agriculture would help cushion the impact of the present and any future crises.

Did you know that

... the garment industry of Cambodia previously benefited from US quota privileges and safeguards against Chinese products? The signing of the Multi-Fibre Agreement with the US in 1995 was the take-off point for the country's garment exports. This MFA expired in 2004, however. The US safeguards against Chinese imports, which secured Cambodian exports even after MFA, expired in December 2008. These developments, together with the current crisis, explain the present struggle of the domestic garment sector.

Source: Better Factories Cambodia (2005, 2008)

… the demand for cars and motorbikes in the country sharply declined from May 2008? Year-on-year growth of car and motorbike import volumes plunged after peaking in May 2008. Apart from the present crisis, such marked decrease in the pace of demand can be explained by the effects of higher energy prices, the real estate downturn, lower real income and, overall, depressed business and consumer confidence.

Source: MEF data, staff assessments