

# **The social impact of the global recession on Cambodia: How the crisis impacts on poverty**

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*Policy brief*

## **Background**

The global financial crisis became visible in September 2008 with the failure of several large financial firms based in the United States (US). It has spread into many countries across the globe, including developing countries such as Cambodia.

With financial and technical support from the Overseas Development Institute (ODI) and the World Bank, the Cambodia Development Resource Institute (CDRI) has conducted an assessment of the impact of the global financial crisis at macro (Jalilian et al. 2009), sector (agriculture, garments, tourism and construction) (Jalilian et al. 2009), household (Tong et al. forthcoming), and individual levels (Tong et al. 2009). This paper highlights the key important findings, and examines the public sector response to date.

It has been widely acknowledged that the impact of global economic downturn on Cambodia's economy is severe, mainly due to the contraction in garments, tourism, and construction. The most severe impact is in the garment industry, with 18% of the total of 352,000 workers (many of whom are women) in the sector having been laid off between September 2008 and May 2009 because of a considerable fall in exports. According to the National Institute of Statistics, this sector employs 4% of the total workforce and accounted for 38% of total employment in manufacturing in 2007.

The number of tourist arrivals in the first half of 2009 amounted to 1,086,518—roughly the same as in the first 6 months of 2008, and an increase of 12% over January–June 2007. However, tourism experienced a contraction (at an average of 3.9%) for six consecutive months from October 2008 to March 2009. As a result, many hotels registered low occupancy rates, and some luxury hotels have temporarily closed. Hotel staff are taking unpaid leave or are being temporarily laid off.

Construction activity is also set to decrease severely as foreign investors in real estate either scale back or suspend large projects due to credit crunches at home.

Most people working in these three sectors are vulnerable to poverty. When they lose their jobs, work less, or have less income, they are likely to fall into poverty.

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1 The views presented here are those of the author and do not necessarily represent the views of the Cambodian Development Resource Institute.

## The impacts of the crisis on poverty

The poverty headcount was estimated in 2007 to be 35% in rural areas, compared with 0.8% in Phnom Penh and 22% in other urban areas.<sup>2</sup> The country's overall rural poverty line was equivalent to US\$0.58 in 2007 (World Bank, 2009). Based on the international poverty line with purchasing power parity, about 40.2% of the Cambodian population of 13.8 million lived below US\$1.25 and 68.2% below US\$2 in 2004 (Bauer et al. 2008). Since poverty in Cambodia is heavily rural based and most rural activities are agriculture based, it is important to consider the effects of the global financial crisis on the rural economy and the agriculture sector.

Agriculture accounted for an estimated 27% of GDP in 2007 and about 59% of the population is also estimated to rely on this sector for their livelihood. Over the past decade, agriculture is estimated to have been growing at an annual rate of 4.6% compared to 13.1% in hotels and restaurants (a proxy indicator for tourism); 25.4% in textiles, clothing, and footwear (a proxy indicator for garments); 13.9% in construction; and 9.1% for the total economy. Offsetting the declines in the rest of the economy, agriculture is expected to grow significantly in volume over last year and is unlikely to be much affected by the global financial crisis (Jalilian et al. 2009).

The 90-household panel data collected in nine villages in rural Cambodia in March 2008 and May 2009 revealed that both per capita income and per capita consumption shrank significantly during the period, by around 30% and 23%, respectively. While there was no significant change in residential or agricultural land holding size, the value of non-land assets fell by 38% over the same period, of which durable assets and livestock declined by 30% and 45%, respectively. As a result, poverty incidence has increased in 2009, using the poverty line up to US\$ 1<sup>3</sup> (Figure 1).<sup>4</sup>

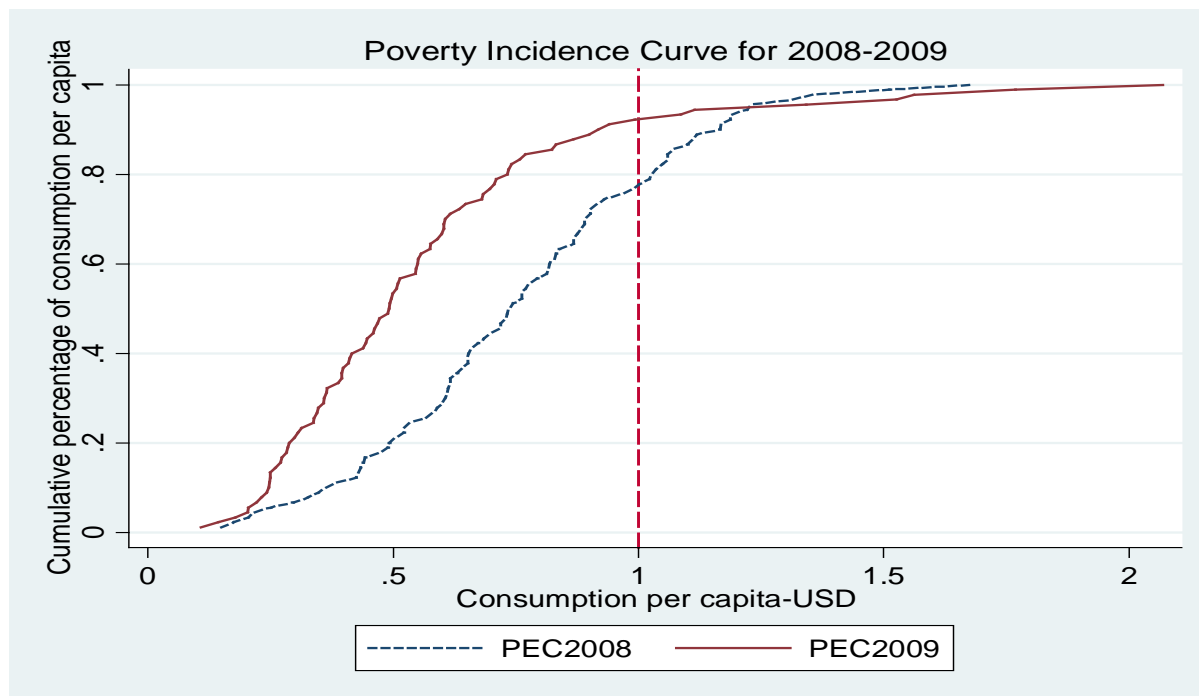
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2 World Bank (2009)

3 World Bank (2009): The 2007 rural poverty line was about 2006 riels, equivalent to US\$0.49 at the exchange rate of 4,063 riels per \$.

4 However, the sample size is small and cannot be taken to be representative of rural areas in Cambodia.

**Figure 1: Poverty Incidence Curve for March 2008 and May 2009**



Source: CDRI survey of 90 households in nine villages in March 2008 and May 2009.

For urban areas, a survey of daily earnings by vulnerable workers in Phnom Penh and two other provinces conducted by CDRI over the past several years reveals that the crisis hit garment workers the hardest, because the garment sector relies heavily on US and European Union (EU) demand.<sup>5</sup> More precisely, the real daily earnings of garment workers fell by 17% between February–May 2007 and February–May 2009. This largely reflects a fixed wage rate, a decline of working hours, and a high inflation rate. Despite this fall in earnings, real daily consumption increased by 14% during the same period, mainly due to a 21% decrease of real daily savings. Obviously, garment workers’ daily consumption cannot be sustained if both real daily earnings and savings continue to decline.

The survey also reveals that average monthly nominal remittances among garment workers amounted to US\$18.4 in May 2009, down from US\$24.4 in February 2009, a decrease of 32%. This significant decline of garment workers’ remittance put great downward pressure on their relatives’ livelihood.

Nevertheless, the crisis impacts on the other nine groups—cyclo drivers, porters, small vegetable traders, scavengers, motorcycle taxi drivers, unskilled construction workers, skilled construction workers, waiters/waitresses, and rice-field workers less substantially. Because the survey purposively selected currently employed or self-employed workers, the results are unable to capture an overview.

Focus group discussions held in May 2009 in Siem Reap province—Cambodia’s tourist hub—confirmed that tourism workers, particularly hotel and restaurant workers, have been affected by the crisis due to the decline in tourist arrivals. Consequently, some staff have been encouraged to take unpaid leave or have been temporarily laid off, which means that they have to engage in informal jobs such as taxi

<sup>5</sup> Since 2000, CDRI had been conducted a quarterly survey of 10 selected vulnerable worker groups including cyclo drivers, porters, small vegetable traders, scavenger, motorcycle taxi drivers, unskilled construction workers, skilled construction workers, waiters/waitresses, garment workers, and rice-field workers.

drivers or part-time English teachers. This kind of labor mobility has led taxi drivers and small traders to work even harder amid low demand.

## Coping mechanisms of the poor and vulnerable

The 90-household panel data show that about 35% and 40%, respectively, of survey households were hit by shocks, particularly idiosyncratic shocks, in 2008 and 2009. The affected households reported that they had spent an average of US\$158 per household to cope with these shocks. More than 80% of the affected households have adapted to shocks by adopting active household strategies involved in making use of physical, financial, and human assets available to the household, including putting further household members into the labor force, working longer hours, selling assets, using savings, borrowing, and migration (Table 1). However, there was no clear evidence that such strategies—particularly selling non-land assets, land, and livestock—were used in response to the crisis.

**Table 1: Use of strategies by affected households**

	Percentage of households	
	March 2008	May 2009
Adaptive strategies <sup>a</sup>	3.13	5.56
Active strategies	81.25	94.4
Social network strategies <sup>b</sup>	2.5	13.8

a. Household responses to shock by changing consumption pattern.

b. Consisting of assistance from friends, family, and nongovernment and government organizations.

Source: CDRI survey of 90 households in nine rural villages in March 2008 and May 2009.

A different dataset collected in March and September 2008 covered 1,003 households in the same nine rural villages and shed more light on households' risk coping mechanism during food price increases. As shown in Table 2, the consumption for non-food items dropped significantly by 20% between March and September 2008<sup>6</sup> while food items declined by only 11%. Although food consumption fell in absolute terms their proportions in total household expenditure remain unchanged, suggesting that households were restricting consumption of non-food items to preserve food consumption.

Despite the fact that different case studies yield different conclusions, they share a common message—rural households in Cambodia are likely to cope with the impact of negative shocks by themselves, adapting their activities and consumption with only fragile, and utilizing informal community safety nets which is likely to diminish during the hard times.

6 Inflation reached 26% in May 2008, the highest level in three decades.

**Table 2: Per capita real consumption by quintile (US\$)**

Quintile of total consumption	Total Consumption		Food		Non-food		Total Consumption	Food	Non-food
	Mar-08	Sep-08	Mar-08	Sep-08	Mar-08	Sep-08	% change March-September 2008	% change March-September 2008	% change March-September 2008
1 (lowest)	0.53	0.48	0.42	0.38	0.11	0.10	-9.04	-8.99	-9.26
2	0.71	0.64	0.55	0.49	0.16	0.14	-10.45	-10.09	-11.64
3	0.85	0.76	0.65	0.58	0.20	0.18	-10.41	-10.88	-8.86
4	1.07	0.92	0.76	0.68	0.31	0.24	-13.68	-10.79	-20.86
5 (highest)	1.86	1.51	0.98	0.85	0.88	0.66	-18.94	-13.21	-25.29
All	0.97	0.86	0.67	0.60	0.33	0.26	-11.38	-11.16	-20.06

Source: CDRI survey data in nine rural villages, March and September 2008.

## Government policy responses

To respond to the global economic downturn, the Government introduced a stimulus policy package that includes:

- Increasing budget expenditure to offset the decline in private investment (to promote economic activity);
- Suspending the monthly turnover tax of 1% on garment factory expenditures;
- Announcing a 10% reduction in export management fees and other costs;
- Setting up the Agriculture Support and Development Fund for the private sector, especially small and medium enterprises, by providing low-interest, short-term credit to farmers in order to increase agricultural productivity and food security;
- Establishing the Prime Minister's Special Fund to provide short-term vocational training to workers who lose their jobs. Up to July 2009, 40,140 laid-off and unemployed workers attended the short-term vocational training courses given by the Ministry of Works and Vocational Training. Of these, 30,720 (76.5%) were trained in agriculture and 9,420 (23.5%) in industry and mechanics;
- Negotiating with the World Bank to finance approximately US\$13 million for various programs associated with the social safety net system.

However, it is unlikely that any impact from these measures has been felt by poor and vulnerable groups in either rural or urban areas.

## Recommendations for the short and medium term

The role that policy makers, donors, and NGOs take may well determine the outcome of the impact of the crisis on growth and poverty in Cambodia. The impact from the global financial crisis is likely to be severe for poor and vulnerable groups: because of their economic and social status, they are likely to be among the first to suffer from any sort of shock, either due to loss of job and income or diminished

purchasing power due to price increases (Jalilian et al. 2009). Given the prevalence of these groups in Cambodia, it is particularly important to emphasize policies required to assist them. In some countries, when faced with increased hardship, the poor are assisted (directly or indirectly) by their governments, donors and NGOs. This support may come in kind or in the form of price subsidies, food rations, food coupons, work-for-food, and school meals, etc.

The crisis does not just result in high variability in living standards, but the lack of means to cope with risk is a cause of persistent poverty. Therefore, both ex-ante and ex-post risk-coping strategies, such as promoting credit and savings as insurance, as well as a credible social safety net, could play a very important role in protecting the poor and vulnerable groups against risk. On the other hand, strengthening informal social insurance should be promoted as, to some extent, poor and vulnerable groups could also use their local social capital to protect consumption from income fluctuations.

## Conclusion

The impact of the global economic downturn on poverty and vulnerable groups is severe in both rural and urban areas. The immediate impacts appear to hit the poor through employment and remittances, and the impact is likely to worsen over the medium term due to weak formal ex-ante and ex-post risk-coping strategies, informal social insurance, and the lack of public response.

The Government should promote insurance to the poor by setting up a regulatory framework for a microfinance institute and providing credibility to the social safety net system.

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