

## POLICY BRIEF

### THE SOCIAL IMPACT OF THE GLOBAL RECESSION ON CAMBODIA HOW THE CRISIS IMPACTS ON POVERTY

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#### BACKGROUND

- The global financial crisis became visible in September 2008 with the failure of several large United States-based financial firms. 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, Cambodia Development Resource Institute (CDRI) has conducted an assessment of the impact of the global financial crisis at macro, sectoral (agriculture, garments, tourism and construction) (Hosseini *et al.*, May 2009), household and individual levels (Tong *et al.*, forthcoming). 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, 18 percent of the total of 352,000 workers (many of them 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 percent of the total workforce and 38 percent of the total employment in manufacturing in 2007. The number of tourist arrivals in the first half year of 2009 amount to 1,086,518—mostly the same as in the first six months of 2008, an increase of 12 percent from January-June 2007. However, it is worth noting that tourism sector has experienced a negative annual growth rate (an average of 3.9 percent) for six consecutive months from October 2008 to March 2009. As a result, many hotels have registered a low occupancy rate, and some luxury hotels have temporarily shut down. Hotel staff is taking unpaid leave or being temporarily laid off. Construction is also set to decrease severely as foreign investors in real estate are either scaling back or suspending large projects due to a credit crunch at home.
- People working in these 3 sectors are mostly vulnerable to poverty. When losing their jobs and working less or having less salary, they are likely to fall into poverty.

#### THE CRISIS IMPACTS ON POVERTY

- The poverty headcount was estimated in 2007 to be at 35% in the 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 USD 0.58 in 2007 (WB, 2007). Based on the international poverty line with purchasing power parity, about 40.2 percent of the 13.8 million Cambodian populations live below USD 1.25 and 68.2 percent below USD 2 in 2004 (Bauer *et al.*, 2008). Since poverty in

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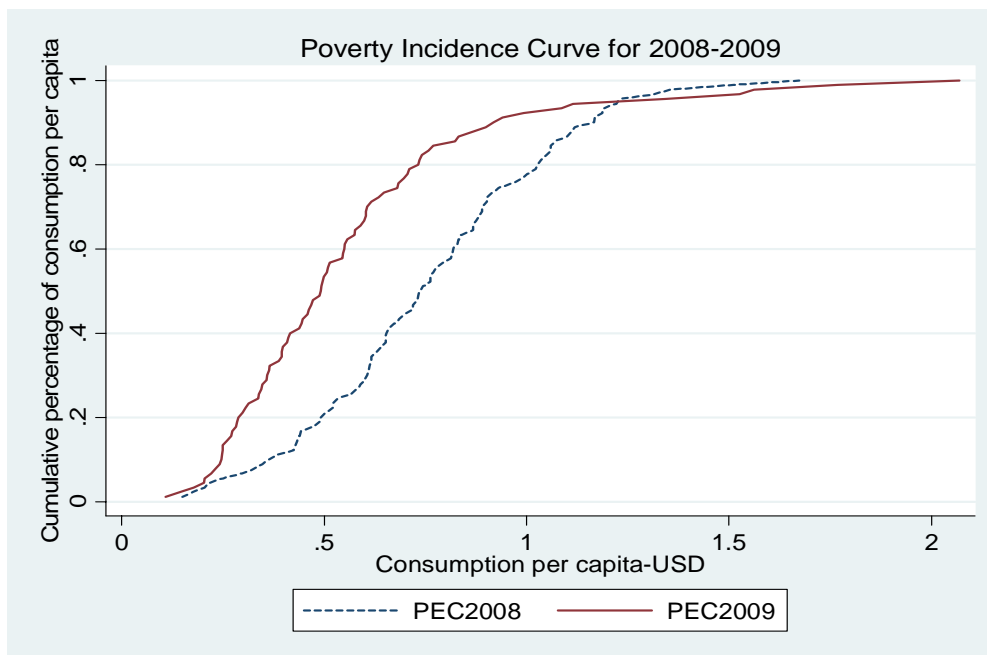
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<sup>2</sup> These figures were also sourced from World Bank's "*Sustaining Rapid Growth in a Challenging Environment*" which in turn credited the data to the results of the Cambodia Socio-economic Survey (CSES) 2004 and 2007 as analyzed by James Knowles.

Cambodia is heavily rural based and most rural activities are agriculture based, it is important to consider the effects of Global Financial Crisis on rural economy and the agriculture sector. Agriculture accounted for an estimated 27 percent 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, it is estimated to have been growing at 4.6 percent compared to 13.1 percent in hotel and restaurant (proxy indicator for tourism), 25.4 percent in textile, wearing apparel and footwear (proxy indicator for garment), 13.9 percent in construction, and 9.1 percent of the total economy.<sup>3</sup> Offsetting the declines in the rest of the economy, the agriculture sector is expected to grow significantly in volume and unlikely to be much affected by the Global Financial Crisis (Hossein *et al.* May 2009).

- The 90 household panel data collected in 9 villages in rural Cambodia during March 2008 and May 2009 has revealed that both per capita income and per capita consumption shrank significantly by around 30 percent and 23 percent, respectively. While there was no significant change in residential or agricultural land holding size, non-land assets dropped by 38 percent between March 2008 and May 2009—of which durable assets and livestock declined by 30 percent and 45 percent, respectively. As a result, poverty incidence has increased in 2009, for all poverty line up close to USD 1.25 (Figure 1).<sup>4</sup>

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



Source: Survey of 90 households in nine villages in 2008 and 2009

- For urban area, a survey of daily earnings by vulnerable worker in Phnom Penh and other two provinces conducted by CDRI over the past several years reveals that the crisis hit garment workers hardest, because the garment sector relies heavily on US and EU demand. More precisely, the real daily earnings of garment workers fell by 17 percent between February-May 2007 and February-May 2009,

<sup>3</sup> WB (2009), *Sustaining Rapid Growth in a Challenging Environment*

<sup>4</sup> The sample of the study is relatively small—not representative of the rural area in Cambodia

all else being equal. This largely reflects a fixed wage rate, a decline of working hours and a high inflation rate. Despite that fact the real daily consumption increased by 14 percent during the same period—mainly offset by the 21 percent decrease of their real daily savings. The garment workers' daily consumption cannot be sustained if both real daily income and savings continue to decline.

- The survey also reveals that average monthly nominal remittance amounted to USD 18.44 in May 2009 down from USD 24.4 in February 2009—a decrease of 32 percent. This significant decline of garment workers' remittance put great downward pressure on their home relatives' livelihood.
- Nevertheless, the crisis impacts on the other nine groups are less substantially. Due to the sample was purposively selected on the currently employed or self-employed workers; the results are unable to capture the overview of the defined workers.
- The 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 been temporarily laid-off, which means that they have to engage in informal jobs such as a motor taxi driver or part-time English teacher. This kind of labour mobility has led motor taxi driver drivers and small traders to work even harder amidst low demand.

### **COPING MECHANISM OF THE POOR AND VULNERABLE**

- The 90 household panel data shows that about 35% and 40% of survey households were hit by shocks, particularly idiosyncratic shock, in 2008 and 2009, respectively. The affected households reported that they had spent an average of USD 158 per household to cope with these shocks. More than 80 percent 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 bringing further household members into labour force, working longer hours, selling assets, using savings, borrowing and migration (Table 1). However, there was no clear evidence that active household strategies—particularly selling non-land assets, land and livestock—were used in response to the global financial crisis.

**Table 1: Use of Strategies by Affected Households**

	Percentage of Household	
	March 2008	May 2009
Adaptive strategies <sup>5</sup>	3.13	5.56
Active strategies	81.25	94.4
Social network strategies <sup>6</sup>	12.5	13.8

Source: Survey of 90 households in 9 rural villages in 2008 & 2009

### **GOVERNMENT'S POLICY RESPONSES**

- In order to response to the global economic downturn, the Royal Government of Cambodia has introduced a stimulus policy package include:
  - Increasing budget expenditure to offset the decline in private investment, to mitigate the impact and promote economic activities.

<sup>5</sup> Household responses to shock by changing consumption pattern

<sup>6</sup> Consisting of assistance from friend, family, non-government and government organization

- Suspending the monthly turnover tax of 1 percent tax on garment factory expenditures.
- Announcing a 10 percent reduction in export management fees and other costs
- Setting up “Agriculture Support and Development Fund” to support private sector—especially the small and medium enterprises, by providing short term credit with low interest rate to farmers in order to increase agricultural productivity and food security.
- Establishing “Prime Minister’s Special Fund” to provide short-term vocational training to workers who lost their job. To date, 40140 laid-off and unemployed workers have attended the short-term vocational training implemented by the Ministry of Works and Vocational Training—of which 30720 (76.5 percent) workers have been trained in agriculture and 9420 (23.5 percent) in industry and mechanic.
- Negotiating with the World Bank of financing approximately USD 13 million to various programs which relevant to social safety net.
- Despite the fact that the Royal Government of Cambodia has launched a number of policies to response to the global economic downturn, it is unlikely that the effect has passed onto the poor and vulnerable groups in both rural and urban area.

#### **RECOMMENDATION FOR SHORT AND MEDIUM TERMS**

- The role that policy makers, donors and NGOs may expect to determine the outcome of the impact of crisis on growth and poverty in Cambodia. Given the extent of poverty and vulnerability in Cambodia, it is particularly important to emphasis policies required to assist these groups. In some countries, when faced with increased hardship, poor are assisted directly or indirectly by their governments, donors and NGOs. This support may come in kind or in the form of price subsidy, food ration, food coupons, work for food, school meals, etc. The impact from the Global Financial Crisis is likely to be severe for the poor and vulnerable groups because their economic and social status are likely to be amongst the first to suffer from any sort of shock, either because of loss of job and income or diminished purchasing power due to price increases (Hossein *et al.* May 2009).
- The Global Financial Crisis does not just result in high variability in living standard, 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 saving 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 the poor and vulnerable groups could also use their local social capital to protect consumption from income fluctuation.

#### **CONCLUSION**

- The impact of the global economic downturn on poverty and vulnerable groups is severe in both rural and urban area. The immediate impacts appear to hit the poor through employment, private transfer and the impact is likely to worsen over the medium term as a weak formal ex-ante and ex-post risk coping strategies, informal social insurance and the lack of public response.
- The government should be to promote the insurance to the poor by setting up a regulatory framework for MFI and providing credibility to the social safety net system.

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