4. Enable and Accelerate the Development of the Private Sector, Especially Small and Medium-Scale Enterprises

The Government considers the private sector as the engine of economic growth, while the government serves as the strategist and manager of development. A healthy private sector is the key to robust economic development and thus the government should ensure the legal framework for fair competition, transparency, accountability and productive relations with the public sector. The overall environment for enterprise will be strengthened through broadened good governance and human resources development.

Most important, the success of private sector development in Cambodia heavily relies upon SMEs. Since the majority of enterprises in the country are Micro and SMEs, the RGC has committed to developing a specific vision, strategy and action plan for Cambodian SME development. To achieve the set goal, the RGC is seriously considering on creating a legal framework for Micro-SME promotion, and establishing the institutional framework within the government to efficiently and effectively coordinate Micro-SME policy.

A. Formalization of the Private Sector

Short Term Actions

- Simplify and streamline the current registration system
- Establish **one-stop service** for enterprise registration
- Establish an inter-ministerial body to review all business licenses
- Inter-ministerial task force to provide recommendations and action plan to the Government.

Medium Term Actions

- Establish a computerized registration system
- Establish computerized database of registered enterprises.
- Streamline licensing procedures

B. Enforcement of the Legal Framework/ Governance

Short Term Actions

- Improve dissemination of legal and regulatory information
- Establish anti-corruption legal framework

• Enact Anti-Corruption Law

Medium Term Actions

• Disseminate legal information on the internet

• Implement commercial arbitration

• Strengthen implementation of anti-corruption measures

• Establish Commercial Court

C. Enhance Market Access/Information

Short Term Actions

• Strengthen trade promotion and market information activities

• Strengthen anti-smuggling efforts

• Reduce trade facilitation costs

Medium Term Actions

• Develop a directory of enterprises, to be combined with the computerized registration system.

• Develop website to promote local products

• Strengthen capacity of customs department to prevent smuggling

• Support formation of business associations

• Strengthen role of Commune Councils to act as local Chambers of Commerce.

• Develop export promotion potential

• Establish industrial zones for exporters

D. Financial Sector Development

Along with progress in governance reform, especially in the judicial/legal system, and the development of the private sector development framework, the Royal Government of Cambodia is committed to establish with full implementation of the ***Financial Sector Blueprint*** a sound, market-oriented financial system, which is characterized as a ***competitive***, ***integrated*** and ***efficient system***.

Competitiveness, supported by a transparent regulatory system and the financial policy, is the primary driving force for the development of financial system.

To concretize the vision set for the financial sector, the Royal Government will immediately assess and take supplementary policy measures to materialize reform agenda in the first phase of the Blueprint, which is set as immediate actions for 2003-2004 of the present Economic Agenda. The policy measures in the second phase of the Blueprint will be implemented as to achieve the medium-term development goals for 2005-2008.

D.1 The Banking Sector

Immediate actions for 2003-2004 need to be focused on accomplishing the development goal set in the first phase of the Blueprint. It aims at laying the foundation for the banking system by establishing basic policy and an institutional framework. To achieve this goal, five intermediate reform agendas are set: (1) establish a basic framework for monetary policy, (2) establish a framework for supervision, (3) restructure the banking sector, (4) establish a framework for the payment system, and (5) establish a capacity-building mechanism.

In the medium term, 2005-2008, policy measures are to enhance intermediation through competition. Building on the achievements in the first phase, the banking system should be developed into a more consolidated system through competition among banks, intermediation will be expanded, and banking services will be extended to the rural areas.

This development goal can be achieved through the following intermediate reform agenda: (1) improving monetary policy instruments, (2) improving the enforcement of prudential regulations, (3) enhancing banking services through diversification, (4) improving the efficiency of the payment system through investments in IT, (5) promoting outreach to rural areas by encouraging the establishment of branches, and (6) strengthening NBC organizational structure.

D.2. Rural finance

To materialize the strategic goal in implementing a basic policy and institutional framework for the rural finance sector, which is set as the first phase in the Blueprint, the Royal Government will pursue the ongoing ADB-funded Rural Savings and Credit Project and its efforts to (1) implementing the policy actions specified in the Rural Credit Policy; (2) strengthening supervision and regulation; (3) facilitating institutional transformation, linkages, and service delivery; and (4) building sustainable institutions. In addition, the agenda will include capacity building for optimal utilization of financial services.

To reach medium-term strategic goal for 2005-2008, which is set to increase the impact of poverty-reduction, the reform agenda includes (1) policy coordination, (2) improving in the application of prudential regulations, (3) establishing a range of service providers, (4) expanding the institutional network, (5) enhancing effective intermediation, (6) promoting innovative micro-finance pilot projects, and (7) introducing safety nets to reduce vulnerability.

D.3. The insurance sector and pension system

Five intermediate agendas are identified to establish the foundation for the insurance sector and determine the feasibility of a multipillar pension system: (1) establishing a regulatory and supervisory framework for insurance, (2) establishing a framework for compulsory insurance, (3) establishing a basis for private sector development, (4) building the capacity of insurance regulators and supervisors, and (5) conducting a feasibility study to establish a multi-pillar pension system.

The key policy goal in the medium-term 2005-2008 is to enlarge and expand the insurance sector through private sector development, and to establish a foundation for the pension system. To achieve this goal, nine intermediate reform actions are needed: (1) strengthening the insurance regulation and supervisory framework, (2) implementing compulsory insurance, (3) promoting a competitive private sector insurance market, (4) increasing outreach to rural areas, (5) establishing a training institution for the insurance sector, (6) developing an actuarial professional body, (7) establishing a legal framework for pension system; (8) establishing a regulatory and supervisory framework for pension system, and (9) building the capacity of pension regulators and supervisors.

D.4. Nonbank financial institutions (NBFIs)

The development of NBFIs is set as the medium-term goal. It is to provide a legal and regulatory framework for the NBFIs commensurate with the development of interbank/money markets and capital markets. This medium goal is to establish the legal and regulatory foundation for NBFIs such as leasing companies, finance companies, investment companies, and money market broker/dealers.

Three intermediate development actions are set to establish the foundation for NBIs: (1)developing the leasing business, (2)developing money market intermediaries, and (3)developing capital market intermediaries.

D.5. Interbank / Money markets

Immediate goal for interbank/money markets development aims to establish the foundation for short term unsecured interbank markets and to provide a base for interbank/money markets through the issuance of T-Bills and the promulgation of a negotiable instruments law. In the medium-term 2005-2008, the RGC will strengthen interbank markets, establish regulations for diversified money market instruments such as negotiable certificates of deposit and repurchase agreements, and develop a primary dealer system and regularize the issuance of T-Bills.

To achieve the above immediate goal, three intermediate reforms are desired: (1) establishing interbank market arrangements for the banking sector, (2) creating an enabling environment for money market development, and (3) creating an enabling environment for T-Bills.

In the medium-term, the money markets will develop to the fullest extent with strengthening of market microstructure, introduction of diverse instruments, and increased participation of financial institutions, including NBFIs. Phase II targets three intermediate reforms: (1) expanding the scope of interbank markets, (2) establishing regulations governing financial institutions' instruments, and (3) developing T-Bill markets.

D.6. Capital Markets

The RGC is committed to accomplish in the short-term the necessary preparatory work to create an enabling environment for capital markets. In the medium-term 2005-2008, it is envisaged to establish the foundation for capital markets by establishing a securities exchange and the necessary infrastructure related to securities trading, as well as by adopting detailed regulations and procedures.

Specific legal and institutional environment is set as the development goal for immediate actions. To achieve this goal, three intermediate reforms are desired: (1) establishing a key legal/regulatory framework, (2) creating an enabling environment for public bond markets, and (3) building capacity for future capital market participants.

Upon completion of the preparatory work and achievements of the above immediate development goal, the RGC envisages to establish a securities market in the medium-term. To facilitate the establishment of a securities exchange, the RGC is committed to address the following reform agenda: (1) establishing a capital market surveillance framework, (2) establishing a securities exchange, (3) promoting the issuance of public bonds, and (4) strengthening capacity building for the public.

D.7. Financial market infrastructure

Immediate actions are to develop key legal, accounting, and information infrastructure for the financial market. Three reform agenda are to be implemented: (1) creating the legal infrastructure to underpin financial sector development, (2) establishing accounting and auditing standards and an enforcement system, and (3) creating a financial market information system.

In the medium-term 2005-2008, the RGC is committed to (1) strengthening law enforcement, (2) strengthening enforcement of accounting and auditing standards, (3) expanding the scope of the arrangements for sharing information among members of the Bankers Association, and (4) enhancing the banking sector safety nets.

5. Ensure Good Governance

Good governance is an essential prerequisite to sustainable socioeconomic development and social justice. Governance is the process of decision-making and formal as well as informal processes through which decisions are implemented. Good governance is participatory, enhances information sharing, accountability and transparency, equitable and inclusive and follows the rule of law. Good governance assures that corruption is minimized, the views of minorities are taken into account and that the voices of the most vulnerable in society are heeded in decision making. Good governance also responds to the present as well as future needs of society.

The Royal Government will focus on the effective implementation of its Governance Action Plan, which covers the five crosscutting areas of judicial and legal reform, public finance, civil service reform, anti-corruption and gender equity, as well as the two specific issues of natural resource management and demobilization of the armed forces.

The Royal Government must be an accountable administration of results. Thus the RGC shall streamline its civil service, using as reference the experience of other countries in the region to build an administration that is adequately supported and remunerated and thereby of sufficient motivation and high productivity.

The key areas of concern and action in good governance in Cambodia include:

Ensuring the Effective Rule of Law

- Improvement of the legislative process, via: (i) public consultations on the draft civil code, the draft code of civil procedure, the draft penal code and the draft code of penal procedure; (ii) streamlining and strengthening of the process to develop law within the executive branch.

- Wide dissemination of law and regulation, by publication of existing and emerging legislation by the legal coordination unit, and periodic publication of an official gazette.

- Completion of gaps in legislation for private sector development, including: (i) comprehensive assessment of gaps and inconsistencies in legislation (ii) Promote the private sector participation in the legislative process, (iii) Prepare a comprehensive framework and program of actions for judicial reforms;

- Developing human resources and infrastructure to strengthen the judiciary: (i) Rehabilitating and building court infrastructure; and (ii) Gradually increase the budget of the judiciary;

- Enhancing the integrity of the judiciary, through: (i) Strengthening the capacity of the Council of Judicial Reform, (ii) Reform and strengthen the supreme council of magistracy, and (iii) Develop and implement detail court procedures and management systems

- Meeting the private sector's needs for the arbitration of commercial disputes, including measures such as specialized commercial and administrative courts, in full consultation with stakeholders;

- Improving law enforcement through the implementation of an action plan to reform public security institutions such as the national police, gendarmerie, municipal police, and other security units.

- Improving representation of the accused, focusing on provincial courts.

Transparency and Anti-Corruption

- Information sharing, transparency, dialogue, consultation and participation must be implemented and enhanced, simply by ensuring that the necessary effort, time and resources for such activities are provided.

- Intensify the battle against corruption, specifically by implementing a short-to-medium-term capacity building program for the National Audit Authority, enhancing NAA operations, and enabling transparency mechanisms.

Streamlined Government Structure

- Improve and restructure public institutions and legal capacity building in government to increase efficiency of the administration and strengthening the state sovereignty and respect for the rule of law.

- To bring the administration closer to the concerns of citizens through the process of decentralization, improving provincial budget allocation, and delegation of responsibilities to the provinces.

- The management overhaul of the entire civil service through better control of personnel in the civil services.

- The establishment of "priority groups" of civil servants, selected in a transparent manner and held to stringent performance standards corresponding to their financial remuneration.

- The further democratization Cambodia through decentralization/deconcentration of government and public service delivery.

Next Steps Toward a Working Version of the Economic Action Agenda

1. SNEC reviews, approves framework; SNEC General Secretariat to refine (July).

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The Economic Action Agenda of the Royal Government of Cambodia 2003-2008

ATT: MS. INABA
FROM: SNEC SECRETARIAT

Preh Reach Kret

(Royal Decree)
on the
Establishment of the Supreme National Economic Council
*****

We,
Preh Bat NORODOM SIHANOUK,
The King of the Kingdom of Cambodia

Constitution of the Kingdom of Cambodia;

Preh Reach Kret No. NS/RKT/1198/72 dated 30 Nov 1998 on the Appointment of the Royal Government of Cambodia;

Preh Reach Kram No. 02/NS/94 dated 20 July 1994 promulgating the Law on Organization and Functioning of the Council of Ministers;

Preh Reach Kram No. NS/RKM/0196/09 dated 24 January 1996 promulgating the Law on Establishment of the Council of Ministers;

Proposal by the Prime Minister of the Royal Government of Cambodia, dated ....;

Hereby, Decided:

Chapter 1: General Provisions

Article 1: The Supreme National Economic Council, thereafter refer to as the "SNEC", is established within the Council of Ministers as a think-tank institution on economic policy for the Head of the Royal Government of Cambodia.

Chapter 2: Functions and Responsibilities

Article 2: The SNEC performs the following functions and responsibilities:

- Reviews and prepares analytical documents, research works, and key speeches which is of vision initiatives, economic development and reform strategies and policies for the Head of the Royal Government;

- Supports the head of the government in monitoring and consolidating reports on the progress in implementation of economic reforms and initiatives set by him;

- Supports the head of the government in monitoring and consolidating reports on the progress involving the implementation of annual plans and other government's development programs, and subsequently provides recommendations to the head of government ensuring the consistency of the various economic policies and streamlining and accelerating those programs and plans;

- Recommends to the head of the government quality and consistent policies within and across sectors, advises him on setting specific targets and objectives for smooth implementation of annual plan's and public expenditure program's strategies and policies;

- Proposes concrete measures aimed at improving economic management and good governance for decision by the head of the government;

- Consolidates and briefs the Head of the Royal Government on national, regional and international economic situation along with recommendations on how to coordinate national economic policies consistent with regional and world economy evolution;

- Arranges for meetings of SNEC with the Prime Minister for his evaluation and guidance aimed at improving the SNEC works.

Chapter 3: SNEC Composition and Structure

Article 3: *Composition and Structure of the Supreme National Economic Council:*

- Headed by a Chairperson and a Vice-Chairperson, both of whom are highly competent and knowledgeable in fulfilling the tasks of analysis and formulation of policies, visions and strategies for the economic development of the nation;

- Supported by at least five members with education and experience in one of the following fields: economics, law, trade, agriculture, natural resource management, environment or industry;

- Each member may have two research and policy analysis assistants, each of whom hold at least a bachelor's degree;

- The Chairperson of the SNEC is entitled to the rank equivalent to Minister;

- The Vice-Chairperson of the SNEC is entitled to the rank equivalent to Minister;

  Members of the SNEC are entitled to the rank equivalent to one of: Minister, Secretary or Undersecretary of State;

- Research and Policy Analysis Assistants are entitled to the ranks equivalent to one of: Director General, Deputy Director General or Head of Department;

Article 4:

The SNEC has one honorary Chairperson selected from among high profile, outstanding personas who are accredited for their contributions and service to the country, highly experienced and being recognized both nationally and internationally;

The honorary Chairperson of the SNEC is entitled to the rank equivalent to Senior Minister;

Article 5:

- The SNEC may have a number of honorary advisors selected from among Cambodian or foreign dignitaries and who are accredited for their contributions and service to the country, highly experienced and being recognized both nationally and internationally;

- The SNEC may have national and international experts/consultants who are highly qualified and experienced in providing technical assistance

Article 6:

- The SNEC is supported by a permanent Secretariat General;

  The SNEC Secretariat General is an executing institution headed and managed by a Secretary General with the rank equivalent to Secretary of State, and supported by two Deputies SG with the rank equivalent to Under-Secretary of State or General Director;

- SNEC staff are civil servants, and if needed SNEC may secure contracted professionals to fulfill the SG functions;

  The organization and functioning of the SNEC's SG are governed by a separate sub-decree.

Chapter 4: SNEC Operations

Article 7: The SNEC convenes its meetings as required upon the invitation by the Chairperson or on the Prime Minister orders;

Article 8:

To facilitate the effective performance of its duties and functions as stipulated in the Article 2 above, the SNEC shall have representatives in the meetings of Council of Ministers and in other inter-ministerial meetings organized by the Council of Ministers and/or line ministries and institutions in order to coordinate the formulation of government policies, strategies and other reform measures.

All concerned ministries and government institutions shall provide full access to official documents and information and cooperation to SNEC as necessary;

The SNEC is entitled to invite senior officials from the government's ministries and institutions, or highly competent personas to join its meetings for comments and inputs.

Article 9: The SNEC is authorized to use the official seal of the Office of Prime Minister for its operations.

Chapter 5: SNEC Resources

Article 10:

The SNEC has its financing from the National Budget,- a separate package allocated under the Council of Ministers Appropriation;

The SNEC is also entitled to receive and manage funds from foreign aids and other sources for its operation and needs for provisions of logistics, equipment and other related allowance as required for improving its performance.

Chapter 6: Final Provisions

Article 11: Provisions of law and regulations against this Preh Reach Kret shall be nullified.

Article 12: The Prime Minister of the Royal Government of Cambodia shall implement this Royal Decree effectively.

Article 13: This Preh Reach Kret enters into force from the date of this signature herewith.

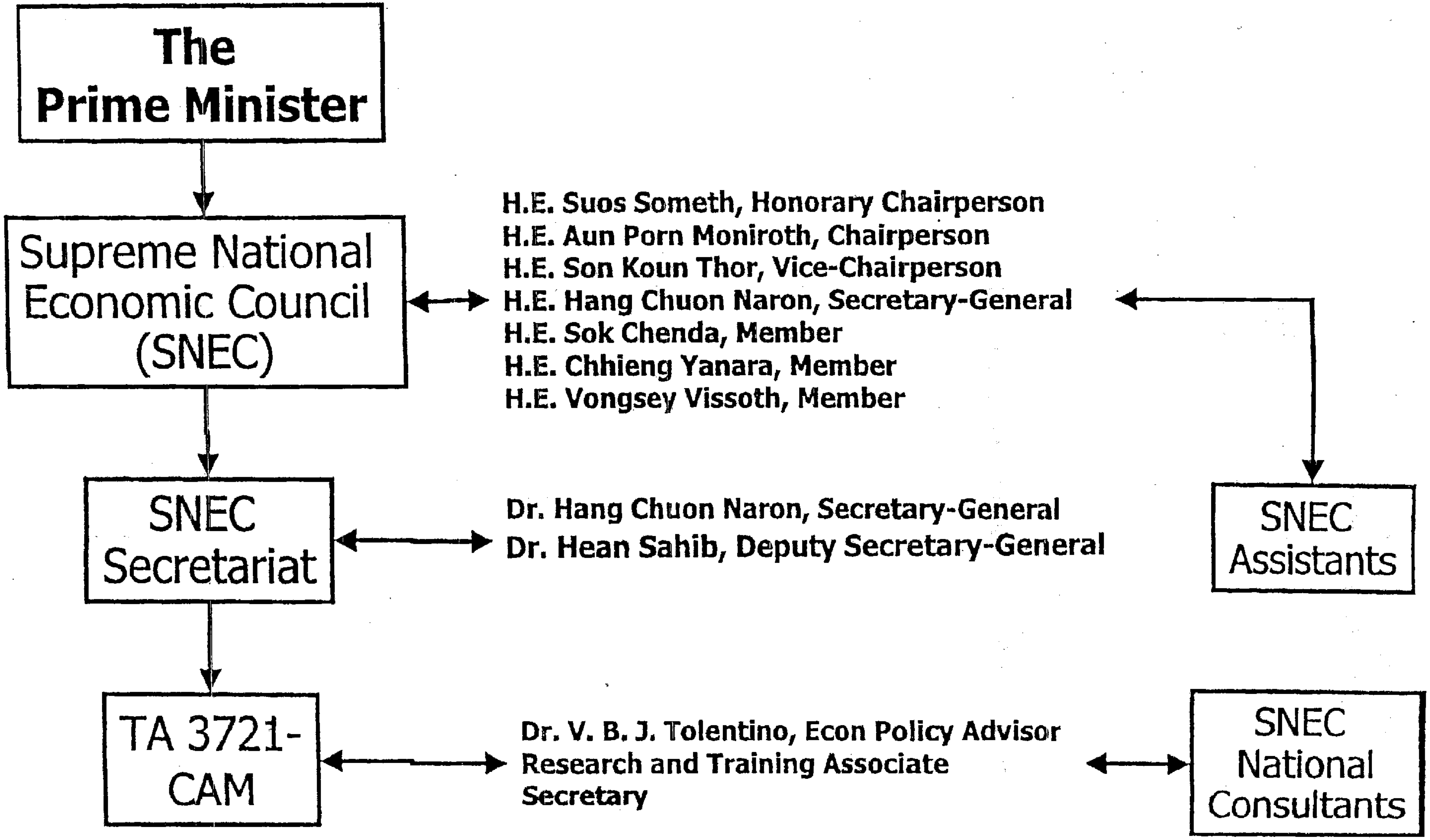
Phnom Penh, ...

The King of Cambodia

NORODOM SIHANOUK

Dr. Hean Sahib, Deputy Secretary-General

SNEC Structure



COUNTRY STUDY ON TRADE IN TEXTILES & CLOTHING

CAMBODIA

October 2003

EXECUTIVE SUMMARY

Cambodia garment industry, the sole industry in-country contributing to 36% GDP and valued at USD 1.3 billion in 2002 export statistics, like most of LDCs' garment industry is at a cross road merely 18 months ahead from Quota Phasing Out environment starting January 1, 2005.

With WTO membership almost assured by September 2003, the main challenge is competitiveness as it means Cambodia would be in same competing context than major players like China and Indian or Bangladesh for that matter.

Presently FOB price differential between Cambodia and Bangladesh for a similar garment is about 30%. Considering any miraculous event whereby corruption could be eradicated in Cambodia, one talks about wiping out only 10% average leaving still 20% gap for Cambodia to catch up on Bangladesh.

With no upstream industry (textile) being set up in Cambodia in the foreseeable future and the setting up of an EPZ (Export Processing Zone) in Sihanoukville (deep seaport area) due to start operations the earliest in 2007, Cambodia has to look at options urgently within these 18 months left before January 1, 2005. Social Accountability appears to be the main card to play for Cambodia to carve herself a niche given her unique BTA with the US linking labor conditions to trade. An emergence of this trend is developing among global players like GAP, Nike, etc that are more conscious of their reputation following pressure from social groups of consumers.

This study covers various angles namely:

Likely shifts in trade flows for Cambodia and product category in view of the elimination of quota system under the ATC and the sort of economic and social impacts.

A glance in the future of T&C industries in Asia and the likely emerging intra-regional competition or cooperation, the unavoidable structural adjustments implicated and the options Cambodia has within WTO context or on bilateral basis to mitigate the situation for Cambodia as less competitive developing country.

The human development implications of changes in rules governing the T&C trade as well as any supportive measures to be put in place for that perspective.

The sort of domestic strategies for Cambodia to eventually transition up the industrial ladder to other industries if she chooses to.

Finally, under special Cambodian circumstances, two analyses are made on following assumptions:

- Potential revenue losses through tariff reduction, should the presently tariffs on exports to US (based on both countries' signed BTA) be extended on MFN basis to all WTO member states.
- Potential loss of market share for Cambodian garment exports should the termination of the ATC not apply as scheduled globally by end 2004 but would instead be made to commence only after the date of Cambodia's accession to WTO.

CONTENTS

A. Introduction

The Garment Industry in Cambodia

One of the most recent newcomers in the international trade of garments has been Cambodia (a non-WTO member country and an LDC). It is has been one of the fastest growing garment exporters over the past 8 years – in 1994 the exports of garments were about USD 4 million and in the year 2002 the corresponding figure was about USD 1.3 billion. In early 2002 Cambodia ranked number 16 amongst the top suppliers of garments into the U.S. market. Modern investments and the following of stringent social responsibility criteria, as stipulated in an agreement with the United States and verified by ILO, have contributed towards this performance.

Under the ILO garment-monitoring project in Cambodia, ILO monitors 192 garment factories for compliance with Cambodia's labor laws and ILO core conventions. Social accountability is in place and the country can be taken as a model for modern working conditions in this industry. In its various reports, ILO found improved labor conditions in the surveyed enterprises. The linkage of trade with labors standards, nevertheless, also had some negative effects. The occurrence of too many strikes, sometimes for petty reasons, had the effect of deterring the buyers because of disruption and delivery time.

The main official Cambodian exports are garments (90%) footwear (5%), wood products (3%) and rubber (2%). Garment manufacturing is almost entirely export-oriented. The main markets for garments are the United States and the European Union. In 2000, Cambodia exported 76% of its garment products to the United States and 23% to the EU[1]

George White, Director of International labor Affairs of the US State Department, in his address to the garment industry players in May 2003 was quoted as saying: *"The success of the garment industry in Cambodia has far exceeded the US government's expectations when one could note that it contributed to USD 1.3 billion in export earnings in 2002, translated into 36% of the country's GDP in that year."*[2]

In this context, U.S. is the biggest market for Cambodian garment exports, where 71 percent of all garments produced in Cambodia are exported to the U.S., 27 percent to the EU, and the remainder distributed among a range of European and Asian countries. In short, Cambodia's garment industry is dominated by sales to the U.S. Consequently, the elimination of the quota system is bound to have a profound impact on the Cambodian economy.

Currently there are over 200 garment factories that employ around 210,000 workers in Cambodia rendering the garment industry as the largest employer in the country by sector. As 90% of the workers in garment factories come from rural areas, the industry has a substantial impact on rural poverty and employment creation. While the labor force in the

[1] Ministry of Commerce – GSP Department
[2] GMAC's Press Release May 26, 2003 – Garment Manufacturers Association in Cambodia

garment industry represents a mere 3.7% of the total labor force, it also commands over 67% of the labor force in the budding-manufacturing sector.

With the average wage rate of approximately $60/month, the labor component of garment production remains highly competitive among countries such as China, Philippines, Sri Lanka and Thailand. The garment industry in Cambodia is represented predominately by foreign rather than local investors. The absence of quotas to the European market has attracted investors from other Asian countries, which are, for the moment, limited by quotas for their own exports.

Table I: Salary in the Cambodian garment sector in comparison with other countries in the region

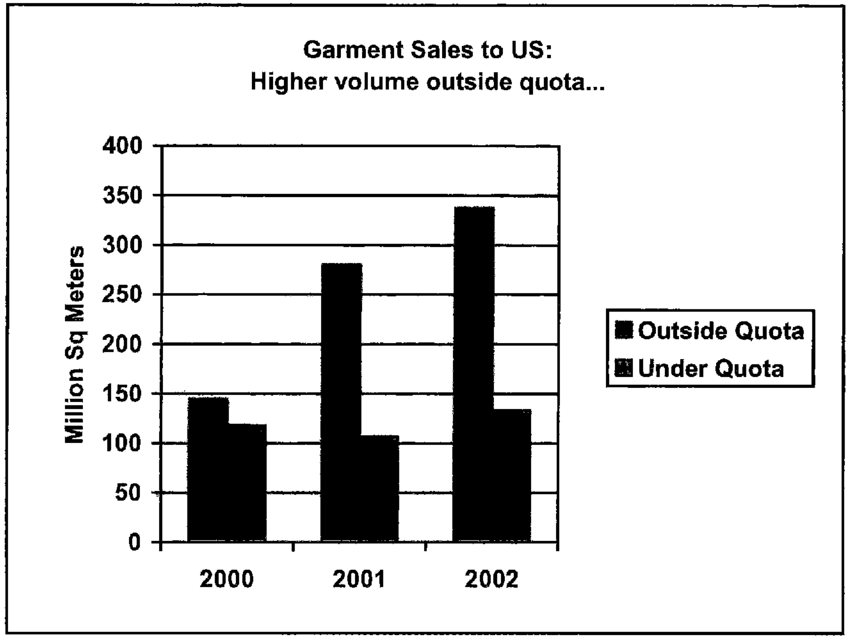
Country	Wage (per month)	Wage (per hour)	Year
Bangladesh	40	0.19	1996
Indonesia	40	0.22	1999
India	57	0.27	1999
Vietnam	60	0.29	2000
Cambodia	61	0.29	2000[3]
Sri Lanka	63	0.31	1998
Thailand	106	0.51	1999
Philippines	182	0.88	1999
China	191	1.14	1997
Malaysia	296	1.42	1995

Source: US Department of Labor and Bureau of International Labor Affairs

Henceforth, the largest investments in the industry come from Hong Kong, Taiwan, China, Singapore, South Korea and the US. Currently, slightly over 8% (15 companies) of the companies operating in Cambodia command over 50 percent of total garment exports. This suggests that the garment industry in Cambodia is highly volatile and susceptible to changes in the world market environment.

[3] Cambodian current Labor Law passed since 1997 only allows 2 hours for overtime per day basis

Growth partly based on quotas that will end
Competitive pressure on profitability of garment sector



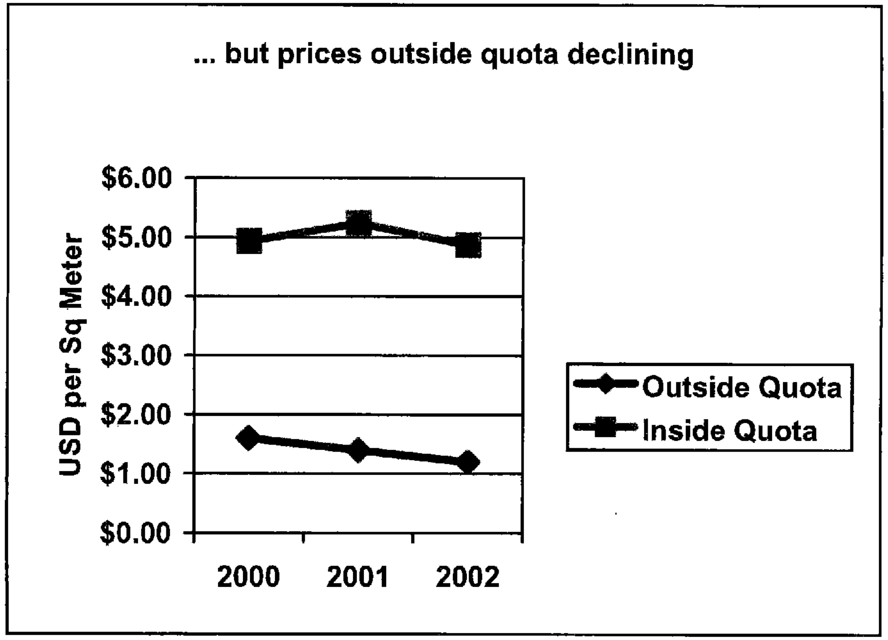


Table II: Labour Cost Comparisons in Textile Industry, 2000

Country	*Operator hours*	*Average cost per operator hour*	*Overtime over normal pay*		*Shift premium*	
			weekdays more than 3 hours	national and religious holidays	second shift	night shift
	per year	$	%	%	%	%
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

Remark: Cambodian Labor Law only allows for 2 hours overtime per day basis

Source: Werner International Management Consultants (***Spinning & Weaving Labor Cost Comparisons, 2000***)

B. Likely Shifts in Trade Flow

Cambodia context

Reliance on the GSP Quota System

Interviews with industry representatives in Cambodia suggest that the sustained growth of the garment industry in Cambodia is largely driven by the country's increasing access to the U.S. market through the MFN/GSP (Most Favored Nation/Generalized System of Preferences)[4]. While Cambodia has MFN/GSP relationships with a number of countries in industrialized markets[5] and countries with economies in transition[6], the single most important export market continues to be the U.S. In terms of volume of exports, trousers/pants,[7] and women's cotton shirts/blouses dominate Cambodian exports to the U.S. As evident from the table below, since 2000 Cambodia has consistently maximized its quota with the U.S. and has enjoyed ever increasing levels of quota for the two largest volume items such as trousers/pants and T-shirts.

Cambodian Garment Exports to the U.S. (dozens)

	2000	2001	2002
Trousers/pants (% of quota filled)	2,956,500 (83.9%)	3,855,021 (84.5%)	3,071,350 (98.6%)
T-shirts (% of quota filled)	3,427,800 (100%)	4,323,388 (76.5%)	3,685,620 (75.7%)

(Ministry of Commerce – GSP – 2002)

Cambodia's exports to the EU primarily consist of pullovers and T-shirts. But the value of exports to the EU is only 38 percent of what is exported to the U.S. market. The heavy dependence of the garment industry on a single market, and a limited number of major investors (15 companies) raises a critical question regarding whether the industry in Cambodia can maintain its competitiveness after 2004, and whether government policies are effectively geared to support the transition from a quota based market.

Crucial Competitiveness Issues

Taking denim jeans as an example, the basic cost structure for the production of a 5 pockets 10/12 oz weight denim jeans is as follows:

4 The US accorded MFN/GSP status to Cambodia but excluded Textiles from GSP status –thus a BTA signed between the 2 countries in 1999--

5 Countries include: Australia; Canada; South Korea; Japan, New Zealand; Norway; Switzerland; US & EU

6 Countries include: Belarus; Bulgaria; Czech Republic; Hungary; Poland & Slovakia

7 Brand names manufactured in Cambodia are: Abercrombie & Fitch, Adidas, Banana Republic, Calvin Klein, Chaps Ralph Lauren, Dockers, Gap, Levi Straus, Original, Old Navy, Union Day, No Boundaries, Santo, LA. Jeans, Nautica, PVH, Union Bay and Wrangler. Buyer Stores are: Sears, Target and Wal-Mart

Basic Cost Structure for Manufacturing Denim Jeans in Cambodia

	Cost	% of Total
Materials and accessories	$4.42	65%
Labor	$1.02	15%
Other inputs	$1.22	18%
Profits	$0.14	2%
Total Cost	$6.80	100%

Source: World Bank Study on Value Chain – *June 2003*

While Cambodia's competitive labor costs is a critical selling point for attracting and retaining investments in the country, the cost of labor constitutes a mere 15% of the total input. Consequently, even if dramatic labor productivity improvements were introduced, that alone would have limited if any impact on the overall competitiveness of Cambodian garment exports.

As Cambodia has practically no production of fabrics[8] or accessories it has been fully dependent on imported inputs for her garment exports. Most of the necessary fabric supplies are coming either from China, Hong Kong, Korea and Taiwan as well as other ASEAN states such as Malaysia and Indonesia. Now, it could be somehow late for the sector to integrate backwards towards the manufacture of yarns and fabrics. Thus, focus must also be directed at understanding factors that contribute to reducing material input costs, which dominate the overall cost of production. More efforts should be directed at deepening the supply value chain and adopt regional (say from Thailand and Vietnam) integration policies to reduce material input cost. The reducing savings from lowering input costs would have a profound effect on the overall garment cost since there would be more scope to reduce inputs (65% of the product cost) than to reduce wages (15% of the product cost).

C. Future of T&C Industries in Asia

In early May 2003 in Brussels, The European Commission for Trade gathered 800 persons from over 70 countries (trade policy makers, industrialists, exporters, retailers, importers and academics) to review the future of T&C Trade in post 2005 when quotas would be removed.

[8] Embryonic state of developing a cotton plantation by a US owned enterprise, Manhattan Textiles, in Cambodia produces currently 120 MT of cotton fiber p.a. compared to its regular imports of 1,500 MT for its own factories needs

A stark revelation that emerged from this milestone meeting was the declaration by big importing countries of their intention to reduce the number of garment supplying countries –and by extension companies—from the current 100 over to below 50.

Despite hard and lengthy discussions throughout the two day conference, everyone ended up none the wiser as per what direction would the global T&C Trade heads to and what remedies could be worked out to soften the blow for some small producing countries or regions. A magma of confusion still reigns supreme after this gathering of industry stakeholders.

Nonetheless, it was a general consensus that larger nations with an integrated textile industry, including cotton-growing facilities, would likely emerge as the major beneficiaries from the quotas removal environment. China obviously comes up as the main winner followed closely by India, Pakistan and Bangladesh to a certain extent. As for the others, the future is somehow uncertain and for them to remain "relevant" would depend on how successful they could undergo painful re-structuring process, especially for LDCs like Cambodia.

African countries were barely mentioned at the conference and Mauritius Trade Minister intervened to remind the audience of this sector's importance for Africa. The African continent nations, in particular LDCs, wished to perceive some solidarity from importing and exporting countries for this trade.

As a response to the challenges of the WTO, one can observe a tendency for a closer regionalization of markets; i.e. preferential market access will be granted on a regional level (e.g. AGOA, Central America/Caribbean, Andean Group, SAARC) and countries adapt accordingly. Furthermore, due to the fact that in most cases possible sourcing, as well as selling markets, can be found on a regional level, a regional approach will maximize the benefits of the selected group of countries from the same region. Closer co-operation in the value chain would also assist these countries in jointly penetrating major international markets (e.g. often market access depends on specific rules of origin, requiring to follow a regional value chain). An ITC expert group meeting recommended a regional approach as the best possible way to overcome the challenges of 2005.

Therefore, national activities will be reinforced at the regional level. Some activities, such as sourcing, will take part in the region, fostering intra-regional trade development (south-south trade). Other regional activities will ensure capacity building through experiences sharing. Close linkages will be develop between the respective T&C manufacturers associations, which do not have any linkages. This would especially be important if it comes to negotiating regional preferences for the countries concerned. Presently, the countries follow a national approach, and are, thus, not fully utilizing their negotiation power. Through a more coordinated approach, the countries could gain altogether.

C.1 - The Chinese Might (or Myth?)

A report commissioned by ATMI (American textile Manufacturers Institute) analyzed that if China follows a similar pattern when quotas are removed, it will quickly within 24 months take control of between 65% to 75% of the US market resulting in the collapse of the US textile and apparel industry, one of the largest manufacturing employers in the United States, translating in loss of 630,000 US textile, apparel and related jobs and the closure of over 1,300 US textile plants. The initial impact should actually be felt in 2004 as US textile mills begin to lose billions of dollars in orders for yarns and fabrics as a result of customers continue shifting orders to Chinese suppliers. Nonetheless, one could query such assessment made by ATMI, being a protectionist lobby group in the US.

Let us have a quick comparison of Chinese and Cambodian productions for the US market in a weak year, i.e. 2002.

Table 1 - U.S. Imports – HS 61 & 62[9] (US$ millions)				
Area	Year	1st Half	2nd Half	Year
World	2001	28,377	30,094	58,471
	2002	25,823	32,804	58,627
Cambodia	2001	455	465	920
	2002	421	606	1,027
China	2001	2,921	3,496	6,417
	2002	2,896	4,173	7,069

Table 2 - U.S. Imports – Percentage Change 2001-2002[10]			
Area	1st Half	2nd Half	Year
World	-9.0%	+9.0%	+0.3%
Cambodia	-7.5%	+30.3%	+11.6%
China	-0.9%	+19.4%	+10.2%

Table 3 - U.S. Imports – Share of Trade[11]			
	1st Half	2nd Half	Year
2001			
Cambodia	1.6%	1.5%	1.6%
China	10.3%	11.6%	11.0%
2002			
Cambodia	1.6%	1.8%	1.8%
China	11.2%	12.7%	12.1%

Source: U.S. International Trade Commission, "Dataweb" internet trade data website.

[9] U.S. International Trade Commission, "Dataweb" internet trade data website.
[10] Calculated from Table 1
[11] Calculated from Table 1.

The year 2002 was a weak year for the US market. Total imports in the first half of the year declined 9 percent. Yet, by the end of the year, as the market rebounded, Cambodia had done well increasing its market share slightly. Of greater concern, though is what happened with Chinese exports. As the US market contracted, the Chinese saw only a very slight drop in exports then a roaring return in the second half to finish the year with strong growth. By year-end, China had increased its market share by nearly a full percentage point!

The point is clearly established: In a weak market, China is perceived of as more competitive than Cambodia. This is due to the priority that a weak market puts on turn time and reduced lead times. Being closer to fabric and other supplies and at least a week closer in shipping time to the US, the Chinese factories simply turn goods on a shorter schedule. In the competitive market conditions expected to follow the integration of textiles and clothing to the WTO, one can only conclude that China shall be a formidable competitor and could inevitably draw orders away from Cambodia.

Much have been said about the impending demise of the smaller garment producing countries after being steam rolled out of business by the mighty Chinese (and/or Indian) garment juggernauts when the ATC expires on 31 December 2004.

This came about a decade ago during the final rounds of the ATC negotiations when the participating nations were broadly classified into a simplistic North (advanced)-South (developing) axis. As most of the trade decisions made within the ATC were based on "pacifying domestic political agenda", the negotiators just decided on a 10 years transition period and let other politicians in power 10 years later to face the trade consequences, if any, wrought by the expiry of the ATC in 2005.

When some of the developing economies (China & India chief among this group) grew faster than their brethrens within the developing fraternity, these upstarts were upgraded and reclassified as newly industrialized economies (NIE). Consequently, this brought about a paradigm shift in the definition of the developing economies and the South (NIE)-South (developing) axis came into existence. The Chine/India versus the rest is a direct manifestation of this South-South equation.

Both the EU and USA concluded textile safeguards measures with China[12] during the latter's WTO accession negotiations with them. On November 15, 1999, the United States and China reached an agreement covering a wide range of bilateral trade issues. Regarding textiles and apparel, the 1999 agreement incorporated the 1997 textile and apparel agreement between the two countries. Major elements of that agreement were (a) China, *upon accession to the WTO*, will "catch up" to the ATC schedule of quota phase-outs by 2005 for other WTO members, but the United States retains the right to impose safeguard measures through the end of 2008, allowing continuation of some quotas under some conditions (under ground rules in effect before the establishment of the WTO), and (b) China will significantly lower its tariffs on a wide range of textile and apparel products,

[12] Refer to Appendix on China Special Safeguard Provisions

and not impose new Non-Tariff Barriers[13] On October 10, 2000, President Clinton signed into law H.R. 4444 (P.L. 106-286), an act that would grant permanent normal trade relations status to China *upon its accession to the WTO*, but also creates mechanisms to monitor China's compliance with the WTO and other trade agreements. Several major issues remain to be resolved before accession.

Many, if not most, developing nations did not deem it necessary to concluded such safeguard measures out of "solidarity" considerations with China. Many, especially the ASEAN countries, are now playing "catch-up" and promoting Free Trade Agreements (FTA) either on a bilateral (1+1) (e.g. India with Thailand) or as ASEAN plus 1 with China. How much the ASEAN countries stand to lose in their EU/USA T&C trade to China/India is left to be seen when the ATC expires on 31 December 2004.

Can China maintain its huge competitiveness without disrupting its main export market, the USA? On 18 August 2003, in response to joint complaints from ATMI, AMTAC and NTA, CITA has published notices in the Federal Register seeking public comments on garment categories 222 (FR.68-49440), 349/649 (FR.68-49444) and 350/650 (FR.68-49448) from China. Another group has invoked the same safeguard under the currency under-valuation complaint. At the Regional Seminar on Post ATC Era Challenges organized in Singapore in mid-October 2003, some inner circles of the US Administration hinted that the US may likely impose some "restraints" on some of the categories from China ahead of the US Presidential Elections in 2004 and the EU may follow suit as they were waiting for the Americans to take the lead. These are exogenous factors that may dampen China's competitiveness.

Some endogenous factors that may increase China's low production cost are:

1. As China's eastern seaboard regions develop and attract higher paying electronics, services and tourism investments, the average factory wage will rise.
2. The obvious solution will be to move westward, inland. Although inland wages are definitely lower than the coastal wages, the infra-structural investments and lead times has to be factored in.

3. Going further inland will entail higher transport charges as both materials and products will have to be transported over a longer distance in and out.

4. Not much has been highlighted so far about the growth of the Chinese domestic apparel market. With increased tourist arrivals and a growing domestic middle class (just like India) this is a grossly understudied sector. It may not be too far fetched to speculate that one day in the not too distant future, due to both economic sense and political expediency, China may have to import some of its domestic

[13] This agreement served as a necessary step toward China's accession to the WTO. On May 24, 2000, the House of Representatives approved permanent normal trade relations with China. For more on U.S.-China trade relations in general and textile and apparel trade in particular, see CRS Issue Brief IB91121, *China-U.S. Trade Issues*, by Wayne M. Morrison, and CRS Report 97-371 (pdf), *China-U.S. Textile Trade: Growth and Confrontation*, by Edward Rappaport.

garments from ASEAN. Economics meaning it may be cheaper to import RMG, say from Cambodia, to the eastern coastal regions than to truck them from inland factories. Politically, China will have to trim down its burgeoning trade balances with its southern ASEAN trade partners. Apparel is a low value product, but very significant employment wise in the exporting ASEAN countries.

Signals are perceived with strong lobbying by ATMI for the Bush Administration to impose some restraints on Chinese imports next year. It remains to be seen if such action would be taken ahead of presidential elections 2004.

C.2 The Indian Counterweight to China

While China is perceived as a low-cost mass producer of low priced garments, India is perceived as a key producer for the high end products of the industry. The Indian Ready Made Garments (RMG) Industry has the second largest labor force in the world to feed labor-intensive garments industry coupled with a mainly indigenous basic raw materials abundance. It has been the largest exporter after World War II and thus is one of the most established exporting countries[14].

Government policies have played an important role in accelerating export of RMG and the government has identified RMG as a thrust area and is providing support to boost exports in the sector. Improvement is sought regularly in modernization process for machinery equipment as well as management techniques in planning and flexibility of operations to cope with market shifts. Various training centers were also set up throughout the country dealing with all aspects of garment-making.

With gradual dismantling of quotas, rationalization of customs tariffs and consequent integration of markets under WTO framework, the Indian textile SMEs need to adopt innovative strategies in retaining and enlarging their market shares. International markets offer better opportunities to widen the sales and increase the profitability of companies. But a large percentage of Indian SMEs shy away from export markets and are contended with domestic market.

The Textiles Committee, a statutory body under Ministry of Textiles, which is implementing Cluster Development Program in 23 textile SMEs clusters in the country and also conducting a nation wide training program for industry personnel, is actively organizing a workshop at present to address following questions & issues as well as providing tools for exploration and management of export business:

[14] Indian Garments Industry in the Post-MFA Period based on the Study on "Export and Management Capabilities of the Indian Garments Industry" conducted by the Institute during January-July 1996.

- Lack of information on overseas markets?
- Absence of awareness about procedures, schemes related to exports?
- Inability in risk taking to do export business?
- Inability to identify right kind of overseas contacts?
- Lack of knowledge on modern IT based business related technology?

EU Trade Commissioner Pascal Lamy recently indicated that bilateral discussions would take place shortly on a new textile package covering enhanced quotas for the Indian textile sector. At the same time, he explained that India's textile exports to the European Union (EU) had increased contrary to the stand taken by New Delhi.

At a meeting with the Indian Commerce Minister Arun Jaitley, P. Lamy maintained that India had not lost its market share in the EU. Further, the concession under EU's Generalised System of Preferences (GSP) had not affected India's trade with the EU.

P. Lamy was responding to remarks made earlier by the Textiles Secretary Mr S B Mohapatra that India's exports to the EU had been hit by GSP concession being extended to its competitors. Mr Jaitley wanted India's concerns in the area of market access including less than full reciprocity in tariff reduction commitments and other special and differential (S&D) provisions for the Third World to be addressed on priority in the current round of multilateral trade negotiations.

P. Lamy signaled the EU's willingness to move forward on a number of areas of concern to India, including modalities for agriculture and non-agriculture market access, movement of natural persons under Mode-4 and textiles. P. Lamy reiterated EU's commitment to the phase-out of textile quotas by the end of 2004 as mandated and noted EU's common position with India on TRIPs and public health issues. Mr Jaitley pointed out that despite some broad areas of convergence, India had domestic concerns, which were not necessarily dictated by politics but by social reality, and cited the example of agriculture where each product could affect the lives of millions of people.

C.3 – Possible Actions

C.3.1 – European Union

EU Trade Commissioner Pascal Lamy suggested to examine granting special GSP facilities to LDCs as well as reconsider existing schemes, in order to make market access more practical. However, clear signals were made to indicate that additional preferential access shall be granted on a multilateral or regional basis only (e.g. no special bilateral treatment shall be provided). EU has granted Cambodia privileges in 2001 under EBA initiative[15].

Pertaining to Rules of Origin requirements, the EU favors regional accumulation to foster regional integration. The US officials also gave similar hints in this respect. With markets in advanced developing countries becoming likely to grow faster than traditional markets in Europe and the Northern American Continent, specific South-South trade preference schemes could be explored.

WTO Deputy Director General Kaa Rana highlighted that by virtue of expected major changes in 2005, in particular the impact on low-income countries, special considerations should be given to LDCs and small suppliers in the form of special preferences and special capacity building efforts. In the case of Cambodia, cohesive work and technical assistance could be followed up in line with what has been achieved so far under the Integrated Framework channel.

On top of that, new market entry barriers emerged over the last decade: ECO labeling, a strong influence of Green Consumerism. During the "Heimtex" Trade Fair in January 2003, European and US buyers are increasingly insisting on ECO standards such as "Oeko-Standard Ecotex 100". All schemes currently serve basically as marketing tool and goods with eco-labels would be targeted to nice markets.

Nonetheless, there is much concern that access to developed markets could be radically reduced due to consumer boycotts of non-labeled goods and aggressive advertising by protectionist domestic industries. Since eco-labels are not presently globally standardized, developing producer countries may face barriers to trade due to:

- Lack of information on basic concepts & terminology
- Definition of eco-label parameters is confusing
- Lack of infrastructure for testing
- High costs of auditing & verification procedures
- Lack of technical know-how
- Difficulties to ensure control at each of the products life cycle stage

C.3.2 - USA

The US government has been using Cambodia as a "show case" for its policy to link labor conditions to trade making Cambodia a unique case in history on that aspect. With the emergence of good corporate citizenship feelings from major buyers whether in US or EU, social accountability importance has become a growing trend.

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[15] Refer to Section (F) under Special Cambodia Circumstances – Paragraph on EU

One cornerstone of western retail firms' reputation is the "how and where" to source from. Though most of retailers only source about half of their T&C requirements directly, with the rest being sourced via agents so retailers had not much clue as per which company nor which country has actually produced the final product. Retailers are presently addressing this issue while they see to their respective codes of conduct, similar and in line with ILO conventions. About everyone in the industry emphasized that "ethical trade requirements' ought to be strengthened and more rigorously pursued in post 2004 quota phase-out environment.

D. Human Development Implications

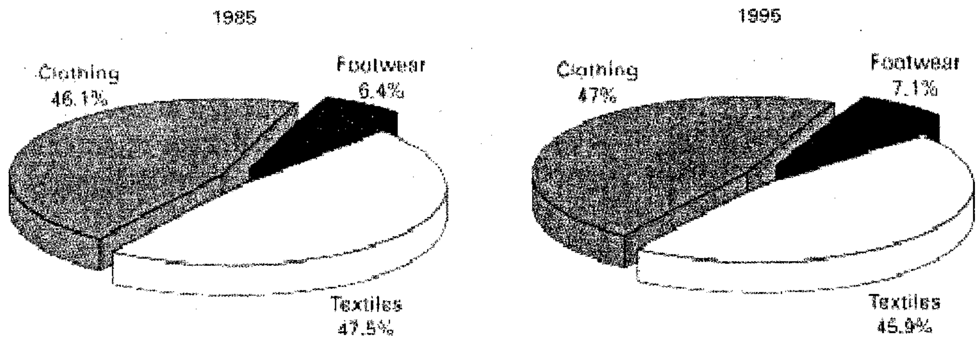
The TCF (Textile, Clothing & Footwear) industries have, traditionally, been important employers for women. Employment opportunities have generally been concentrated in the lower range of qualifications and, very often, in countries with limited alternative job opportunities. These factors have contributed towards maintaining wages in these sectors at relatively low rates.

While these industries are an invaluable source of employment, particularly for women, they have mainly provided opportunities for unskilled workers. Tending to occupy positions in simple production, women have not, until recently, played a significant role in higher positions of responsibility.

At the world level, the distribution of female employment among the TCF industries was the following in 1995: 46% in the textile, about 47% in the clothing and 7% in the footwear industries. As demonstrated in the following figure, this distribution had changed only slightly since 1985, when the shares were 47.5%, 46% and 6.4%, respectively.

In industrialized countries, and in particular in Western Europe, increasing competition from low labor cost countries prompted a change in employment patterns. In particular, the unskilled jobs typical of the clothing and textile industries were greatly affected by the need to reduce the importance of labor costs in production costs. Attempts to introduce new technologies and automated manufacturing methods, as well as relocation of production, resulted in a restructuring process leading to considerable job losses. Women were the first to be affected, as machines replaced the low-skilled jobs which they had traditionally filled and they were not always sufficiently trained to cope with the higher skills needed for operating these machines.

. **Distribution of female employment among TCF industries**



Source: ILO - UNIDO

Cambodia's present human resources base has been decimated by decades of civil war and isolation and is negatively affected by low level public expenditure on education, less than 2% of GDP. Though officially free of charge schooling on primary and secondary level, the education system is heavily reliant on households' private contributions for unofficial school fees and other expenses in the form of books and uniforms. Financial constraints are a major cause for the low completion rate for primary and secondary education with only 37% literacy rate.

This is coupled with a shortage of qualified teachers, adequate educational materials and appropriate curriculum. Vocational training has turned out to be a more important aspect of HR development over the last few years through the establishment of many private sector and NGO managed programs. Issues remain on the development of training standards and access to training due to its high cost and limited availability in rural areas. So far, the government has been unable to provide corporate-based skills such as management training[16]

With 53% of the population being female, the weak gender plays an important role in contributing to household daily income and the garment industry has a high proportion (90%) female work force.

Though the industry, through its association GMAC, has been running a Training Center, CGTC (Cambodia Garment training Center), sponsored for the final year 2003 by JODC (Japan Overseas Development Corporation) since 1999 but more specific and relevant curriculum needs to be inserted to address the industry needs such as simple seamstress, mechanics, design, etc... To-date the center was only dispensing courses for supervisory level like line leader.

[16] ADB (Asian Development Bank) Private Sector Assessment on Cambodia – *June 2003*