# Cambodian place in the International trade of Textile and Clothing: Threat and Opportunity

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**Abstract**

This paper analyzes the threat and opportunity of textiles and clothing industry in Cambodia by employing SWOT analysis, quantitative method of revealed comparative and competitive advantage. The findings reveal that Cambodia has both comparative and competitive advantage of garment industry comparing to another Asian garment exporting countries-namely India, Pakistan, Thailand, and Vietnam, except Bangladesh. Whereas the Cambodian textile industry experiences both comparative and competitive disadvantage as it obtains the lowest score among counties in this study. Our analysis shows that the Cambodian T&S sector faces the risk of EBA, negative impact on the US-China trade war. Vietnam's readiness, along with good trade policy between India and Bangladesh, is also has a negative impact on Cambodia. Cambodia must consider long-term and medium-term strategies to expand competitiveness for T&S exports. Nevertheless, the term of trade could obtain positive growth since the price of garment and textile products experiences an increasing trend.

**JEL Classification:** F18, F21, F53, L16, L52,
**Keywords:** Textiles and Clothing, Everything but Arms, Revealed Comparative Advantage, Revealed Competitive Advantages, Trade Policy.

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# I. Introduction

The textile sector is Cambodia's largest manufacturing sector. About 40% of Cambodia's GDP comes from clothing exports, while more than 800,000 people work in clothing factories across the country. The Cambodian economy has a long history of reliance on the apparel sector, which employed 847,419 people in 2017, or 86% of the 982,203 employed in the industrial sector. These plants generated revenues of $10.79 billion last year, an increase of 70% over 2013. Over $7 billion of this came from the export-oriented apparel sector, while domestic industries generated $2.62 billion.

Cambodia had a total of 1,522 factories registered in 2017, up 37% from 5 years ago, with 1,108 factories. This growth was halted last year, when the number of plants actually declined for the first time in five years, down slightly from the historical record of 1,579 in 2016. The slight decline in the total number of factories could be attributed to the government's performance in diversifying garment factories and pursuing larger projects. The number of garment factories has increased by 29% in five years to 1,031, or about two-thirds of the total number of factories. According to figures from the Ministry of Commerce (MoC), Cambodia's total export volume reached $9 billion in the first nine months of the year. 80% of these exchanges consist of clothing or footwear. The main export markets for Cambodian apparel are the European Union, the United States, China, New Zealand, and Japan.

However, the EU remains the largest market for Cambodian clothing and footwear products, absorbing 46% of exports in 2017, while retaining about the same share as in 2016. The United States remained the sector's second-largest destination, accounting for 24% of the sector's exports in 2017, roughly the same share as the same period in 2016. The two markets are the main importers of Cambodia's clothing and footwear sector, absorbing a total of 70% of the sector's exports.

Nonetheless, the sector is facing threats from increasingly competitive regional neighbors, the inevitable shift to automation and the potential loss of preferential trade agreements such as anything but the arm (EBA), the American Apparel and Shoe Association (AAFA), the Faire Labor Association (FLA), and six other apparel industry organizations. Faced with the loss of preferential trade agreements due to the dissolution of the main opposition party and violations of workers' rights and the human rights situation in the country. Moreover, because of the lack of electricity and the high cost of logistics, the apparel sector is facing several risks that threaten the sector's future in the short and long term.

The rest of the paper is organized as follows. Section 2 links this paper to the demand side and supply side of PRC and Vietnam. Section 3 presents the India, Bangladesh and Pakistan in Textiles and Clothing. The empirical results are presented in Section 4, while Section 5 explores the Cambodian opportunities in Textiles and Clothing and the Section 6 concludes.

# II. Demand side and Supply side of PRC[2] and Vietnam

On the demand side, show that strong competition between the PRC and Vietnam in a very limited number of items. In the majority of three-digit categories originating in the PRC, there was no significant cross-price elasticity of demand. The reality behind the regression results is that the quality of PRC T&A[3] products improved drastically while Vietnam has only a single cost advantage, cheap labor. The share of labor cost in total value added of Vietnam's T&A industry is lower than in other countries. The lower ratio of labor share in total value added could be explained by the low relative price of labor over the capital in Vietnam, which is much lower than in some other Asian economies.

On the supply side, it is apparent that the single most important systemic difference, which can be attributed to cultural differences, is the reliance in PRC on the central planning to organize the development path of the entire T&A industry. It was the state that encouraged major technological changes, a research for economies of scale and a shift from merely producing as subcontractors to developing a unique fashion and downstream linkage mechanisms. Vietnam is still in its early stage to follow the PRC model (Pelzman & Shoham, 2010).

Input-Output Analysis for Vietnam from 1996 to 2007, an important source of information for the investigation of the inter-relations existing among different industries. Used to determine the role and importance of different economic value added, incomes and employment and it analyses the existing connection in an economy (Van Chung, 2014). It shows that during 1996 to 2007 Vietnam government try to change economic structure from the economy depend on agricultural in to industrialize economy. However, with the higher output of industries like machinery, other manufacturing …, especially textile and clothing industry the income of employee still not improve than before. Furthermore, the earning multiplier as well as the value adds multiplier of the textile and clothing are lower and look like decrease compare with agriculture sector.

**Viet Nam-EU free trade agreement:** In October 2018, after three years of negotiation, Viet Nam and the EU reached agreement on a free trade deal. The new EU-Viet Nam free trade agreement will eliminate more than 99% of all tariffs, the most salient of which in respect of Cambodia will be the removal of duties on all textile fabric trade between Viet Nam and the EU. These duties are currently set at 12%. This development comes in a context in which Viet Nam has been a very successful long-term competitor to Cambodia's garment and footwear sector. The minimum wage for workers

[2] The Peoples Republic of China

[3] Textiles and Apparel

in Region I of Viet Nam (the highest minimum wage region amongst Viet Nam's four minimum wage regions), was set at USD $180 per month for 2019, approximately on part with the national minimum wage rate in Cambodia. (ILO, 2018).

**Notice on Everything But Arms (EBA) trade privilege access:** In October 2018, Cambodia was served a notice of the launch by the EU of a process to withdraw Cambodia's duty-free and quota-free access to the EU Single Market under the Everything But Arms (EBA) scheme[4]. This notification gave rise to an 18-month negotiation process inclusive of a 6-month grace period, the outcome after the twelfth month of which would lead to a decision on either revocation or retention of Cambodia's participation in the scheme. Many observers consider that the EBA scheme has been an important driver of the strong growth of Cambodia's garment and footwear sector over the past several years.

Therefore, losing EBA preferences, which currently provide Cambodia full duty-free and quota-free access to the EU for all their exports with the exception of arms and armaments will likely slow Cambodia's export growth, and negatively impact its labor market in the short term.

In the absence of such privileges, the majority of Cambodia's exports to the EU will face a tariff rate of approximately 12 percent. This is a significant development in a context in which, as highlighted above, the EU remains the largest market for Cambodia's garment and footwear exports, having absorbed some more than 44 percent of the sector's export in the first-nine months of 2018.

Trade disputes among major economies, especially the United States and China, will negatively impact global trade and disrupt regional and global value chains, with uncertain impact on Cambodia. Given Cambodia's increased dependency on China for its FDI, tourism, and official development assistance, a sharp downturn in the Chinese economy will diminish Cambodia's growth outlook in the short and medium term. The hardening of global monetary conditions and appreciation of the U.S. dollar could erode the competitiveness of exports, given Cambodia's high level of dollarization. (Sodeth & Miguel, 2018).

## III. India, Bangladesh and Pakistan in Textiles and Clothing

India and Bangladesh enjoy strong bilateral economic and trade relations, and a gamut of factors have contributed to the sustained growth of trade between the two countries. These factors include a long open border, similar value systems, geographical contiguity

[4] The Everything But Arms (EBA) scheme grants full duty free and quota free access to the EU Single Market for all products (except arms and armaments). See further: http://trade.ec.europa.eu/tradehelp/everything-arms

and common linguistic competencies. Bilateral trade in T&C[5] products gives a reasonable understanding about the existing value chains in T&C products between the two countries (Kabir, Singh, & Ferrantino, 2019).

Existing bilateral value chains between India and Bangladesh offer valuable inputs on global T&C value chains. In this context, there are two important developments:

(i) Pre-2005 quota period: During this period, as a developing country India was exposed to quotas under MFA that restrained its T&C exports beyond a prescribed limit. This resulted in an exodus of Indian T&C manufacturers and exporters into Bangladesh to access the quota-free global market. This also helped them develop strong backward and forward linkages. Soon they started importing cheap raw materials, such as yarn, fabric and denim fabric from India, processed them in Bangladesh and began exporting the finished products to the rest of the world. Therefore, the quota regime has strengthened the T&C sector of Bangladesh.

(ii) Preferential Market Access: Being a Least Developed Country (LDC), Bangladesh enjoys better market access under the Generalized System of Preference (GSP) compared to India. Bangladesh has significant labor cost advantages vis-à-vis India and other Asian countries in the T&C sector.

The monthly wages applicable to the garment sector in India are higher than that in Cambodia and Cambodia are higher than that in Bangladesh (Figure 4). This gives an added advantage to Cambodia and Bangladesh in global market, thus improving the cost competitiveness of Cambodian and Bangladeshi T&C firms in global markets. On the other hand, the United States (US) has challenged the export promotion programs of India in the WTO Dispute Settlement Mechanism (DSB) as it has recently crossed the threshold limit of US$1,000 per-capita income for the last three years. Therefore, India may have to review its export promotion programs to make them WTO-complaint. However, a reduction in export incentives may affect the export competitiveness of India's T&C products.

**Trade Policy of India:** The Government of India has given substantial attention to its trade policy due to the strong linkages of the T&C sector with the domestic economy, as well as its role in exports of the country. The Foreign Trade Policy (2015-20) includes several schemes aimed at promoting exports of the T&C sector.

[5] Textiles and Clothing

**Investment Policy of India**: India has also undertaken a number of initiatives to promote investment in the T&C sector. Some of the key initiatives undertaken by India are Technology Up-gradation Fund Scheme (TUFS), Scheme for Integrated Textile Park (SITP), and Integrated Skill Development Scheme (ISDS).

**Trade Policy of Bangladesh:** Bangladesh's trade policy gives considerable focus on promoting exports of T&C. The preamble of Export Policy (2015-2018) focuses on three aspects of the T&C value chain: (i) strong forward and backward linkage within the industry, (ii) easy access to raw materials for export items and (iii) overall improvement of Chittagong and Mongla sea ports with easy loading-unloading capacity of the port.

**Investment Policy of Bangladesh**: Bangladesh ensures legal protection to foreign investors against nationalization and expropriation. This privilege is provided under the Foreign Private Investment (Promotion & Protection).

**Trade Barriers and Trade Facilitation:** Trade policies are inextricably intertwined with GVCs[6], having an all-pervasive influence on their functioning. The increasing inter-dependence of trade policies has been an integral part of "trade policy formulation and negotiations" across the countries for a long time. The emergence of GVCs in global trade has transformed the role of trade policies and their impact on the functioning of GVCs. Traditionally, goods were being produced in one country and then exported to other countries. The global trade framework was simpler and competition took place between domestic and foreign goods with their own national characteristics. Consequently, countries levied high tariffs on imported products to protect domestic producers and this was largely motivated by the state of the domestic political economy that generally favored protectionist policies to cater to the interests of domestic producers even at the cost of consumer welfare. Customs tariffs and other charges were seen as major contributors to public revenue. Thus, high tariffs served the dual purpose of protectionism and public revenues.

Bangladesh and India are lagging behind their comparable countries in Southeast Asia in logistical performance. The World Bank's logistics performance index (LPI) is used to compare the performance among India, Bangladesh Cambodia, Malaysia and Vietnam on various parameters, including - efficiency of the customs clearance process, quality of trade and transport-related infrastructure, ease of arranging competitively priced shipments, quality of logistics services, tracking and tracing consignment, and timeliness. The sub-parameters of the LPI show that Malaysia and India perform relatively better than Bangladesh, Cambodia and Vietnam (Figure 3).

[6] Global Value Chain

India is one of the world's leading producers of man-made filaments and Pakistan's competitive advantage lies in cotton production. In the South Asian region, India, Pakistan, Bangladesh and Sri Lanka are the major T&C exporters. Pakistan and India could join hands with Bangladesh and Sri Lanka to jointly liberalize trade in at least those textile value chain items that they import from outside the region to reduce their costs owing to lower transportation costs. There is huge diversity in terms of the T&C production in South Asian countries. There is a need to enhance the exchange of T&C with different levels of processing between India and Pakistan. This would eventually pave the way for collaboration in the textiles segment within South Asia and help the region to gain access to the supply chains in textiles (Nisha, Saon, & Devyani, 2016).

In Pakistan, textiles and clothing comprise 52.5 percent of the country's total exports. For India and Bangladesh, the World Integrated Trade Solution database reports corresponding proportions of 11.3 percent and 88.1 percent, respectively. In studying the comparative advantage of these three countries with respect to textiles and clothing, we conduct dynamic analysis of the last four decades. (Shahzad, 2015).

## IV. Revealed Comparative Advantage and Competitive Advantages

Cambodia could obtain both comparative and competitive advantage in garment, not textile industry. Also, garment and textile exports represent 15% to Cambodia's GDP and over 60% of total export, the decrease of labor productivity largely effects on its macro indicators and spilled-over effects on related sectors. Empirically, Cambodia obtains labor abundance and low relative labor cost; even so, decrease of labor productivity in these industries reduces its competitiveness and economic of scale (El Monineath, 2016).

Over period of study from 2000 to 2014, data from two reliable sources garment and textile export database taken from World Trade Organization (WTO); total world and each country exports database taken from International Monetary Fund (IMF); also, take base comparison vis-a-vis major Asian garment and textile exporting countries such Bangladesh, India, Pakistan, Thailand, and Vietnam.

Results from revealed comparative advantage of Balassa index could be seen from Figure 1.1 that Cambodia does have comparative advantage in garment industry over the period of 2000-2014 at average RCA (24.59). Comparing to other Asian garment exporting countries, Cambodia has more comparative advantage than Pakistan (11.21), Vietnam (5.45), India (2.90), and Thailand (1.18), except Bangladesh (32.00). However, Cambodia obtain comparative disadvantage for textile sectors since its RCA (0.42) is less than 1; whereas, its competitors-Bangladesh (4.36), India (4.02), Pakistan (31.49), Thailand (1.16), and Vietnam (1.64) are able to obtain comparative advantage over period of the study.

Results from revealed competitive advantage of white index depict that Cambodia still obtains competitive advantage of its garment industry since its average RCE scores (23.81) bigger than 1 over the studied periods. Similarly, comparing to other Asian garment exporting countries, Cambodia has higher comparative advantage than Pakistan (11.14), Vietnam (5.08), India (2.88), and Thailand (1.14), except Bangladesh (31.33). Even so, Cambodian textile industry sill achieves competitive disadvantage as it experiences negative RCE of 17.77 (Figure 1.2). Whereas, other textile export-oriented countries also experience competitive disadvantage such as Bangladesh (-3.62), Vietnam (-2.79), Thailand (0.29), except Pakistan (29.96) and India (3.50).

## V. Cambodian opportunities in Textiles and Clothing

The industry took off in 1999, with the bilateral textile agreement between the US and Cambodia, which granted Cambodia access to the US market for three years under the Multi-Fiber Agreement (MFA) quota system, and with the privileged access, the EU granted to Cambodian apparel exports. Under the MFA, the initial quotas granted by the US to Cambodia were the most generous for any country (in per capita terms) and the agreement established that the quotas would increase annually if the country's arms and factories accepted to comply with internationally agreed labor standards, as well as the country's labor law. This initiative, initially known as the Better Factories Cambodia was the genesis of the Better Work Program, which currently operates in seven additional countries (Mejía-Mantilla & Woldemichael, 2017).

The MFA was extended for another three years in 2001 and it finally ended in 2005. Cambodia's access to the EU has continued under the Everything but Arms Initiative (EBA), established in 2001 and, as mentioned, is nowadays the main garment export destination for the country. Access to both the US and the EU textile markets was a major incentive to investors from China; Hong Kong SAR, China; and the Republic of Korea, and the industry boomed in the country. Between 1995 and 2014, the contribution of Cambodia's garment exports to the world's garment exports increased from 0.1 percent in 2000 to 1.8 percent in 2014 (Figure 2).

There have been a number of recent key policy developments relating to the garment and footwear sector in Cambodia (Netherlands, 2018), including:

**New minimum wage for 2019:** The Ministry of Labour and Vocational Training (MoLVT) announced in October 2017 an increase in the statutory minimum wage, following rounds of negotiations between unions, employer’s representative and the Labour Advisory Committee (LAC). From 1 January 2019, workers in the garment and footwear sector will see their monthly minimum wage rise to USD $182 per month. As a departure from practice over the previous three years to date, no announcement on an increase in income tax thresholds has been made, thereby brining worker’s income closer to the tax threshold.

**Payment of seniority indemnity:** In September 2018, the MoLVT issued a Prakas (Ministerial regulation) on payment of a seniority indemnity, to take effect in 2019. The Prakas changes the practice of indemnity to two pay-outs per year from the previous practice on payment upon exit from employment. Under the Prakas, qualified workers will receive indemnity pay equal to 15 days of their wage and benefits per year with regular pay-outs in the months of June and December. Observers consider that the Prakas was issued in response to recent incidents affecting the garment sector in Cambodia involving bankrupt employers absconding on their obligations to pay workers.

**Wage payment for workers/employees:** In September 2018, the Ministry of Labour and Vocational Training (MoLVT) issued a Prakas (ministerial regulation) on wage disbursement to workers/employees. Effective from 1 January 2019, wage payments will be made two times per month. The first payment in the amount equal to 50 percent of net monthly wage is to be made in the second week of each month, while the second payment in the four week of each month.

**Technical and vocational training:** Currently, the majority of labour within the garment sector is concentrated in low-value added CMT production. Indeed, most workers do not go through any technical training as employers have little incentive to enhance their workers' skills. However, over the medium and long terms, this skill gap stands as an impediment to the development of more sophisticated products, thus preventing Cambodia to effectively climb up the value chain. For this reason, efforts are being made to encourage skill development through both formal and non-formal education. The development of technical and vocational training (TVET) curriculums will undoubtedly increase workers' productivity, thus justifying their higher wages in the eyes of investors. Such programs could greatly benefit from foreign support and investment. Dutch firms with expertise in curriculum development for TVET courses, or in manufacturing technology for the garment industry may find opportunities in Cambodia.

**Working conditions:** The garment industry is the only one in Cambodia for which there is a stipulated minimum wage. Between 2008-2012, the minimum wage of this sector grew at a rate of less than 10% year on year. Labour unrest in late 2013 voiced up a concern for government and investors. With the presence of collective negotiation, the issue later was alleviated by an increase in minimum wage, from USD 80 per month in 2013 to USD 128 in 2015. The Ministry of Labor and vocational training recently announced a remarkable increase, up to USD 170 per month for garment and foot wear workers in 2018. Although these developments could be perceived as an increased cost by investors, they can alternatively be seen as providing a fairer income to employees, more than 80% of whom are women, usually below 30 years-old. Moreover, under the supervision of the International Labor Organization (ILO), the implementation of the Better Factories Cambodia (BFC) program, including unannounced factory inspections, has significantly improved the sector's standards for working conditions. These improvements could become a sale argument for suppliers. Indeed, international clothing brands are facing mounting pressure from consumers for ethical products, following several past scandals in various countries.

The results of the hypothesis testing by (Sribunrueng, 2018) showed that working environment in the aspect of design of the working environment and safety and sanitation of the working place had an influence on the efficiency of the employees' work performance in terms of the quality of the outcome of work.

# VI. Concussion

Cambodia could obtain both comparative and competitive advantage in garment, not textile industry. Also, garment and textile exports represent 15% to Cambodia's GDP and over 60% of total export, the decrease of labor productivity largely effects on its macro indicators and spilled-over effects on related sectors. Empirically, Cambodia obtains labor abundance and low relative labor cost; even so, decrease of labor productivity in these industries reduces its competitiveness and economic of scale. Our analysis shows that the Cambodian T&S sector faces the risk of EBA, negative impact on the US-China trade war. Vietnam's readiness, along with good trade policy between India and Bangladesh, is also has a negative impact on Cambodia. Cambodia must consider long-term and medium-term strategies to expand competitiveness for T&S exports. Nevertheless, term of trade could obtain positive growth since price of garment and textile products experiences an increasing trend.

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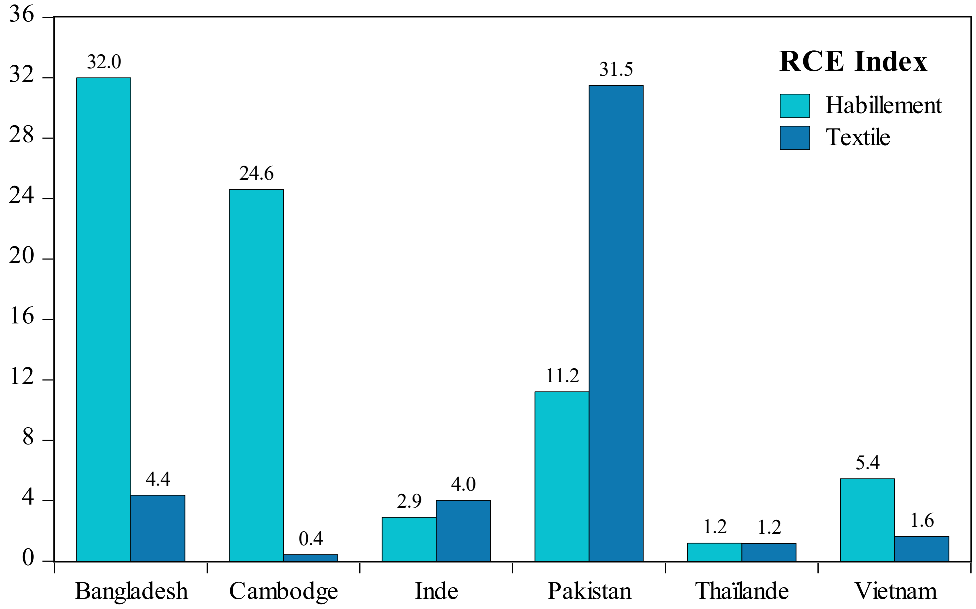
# Appendix

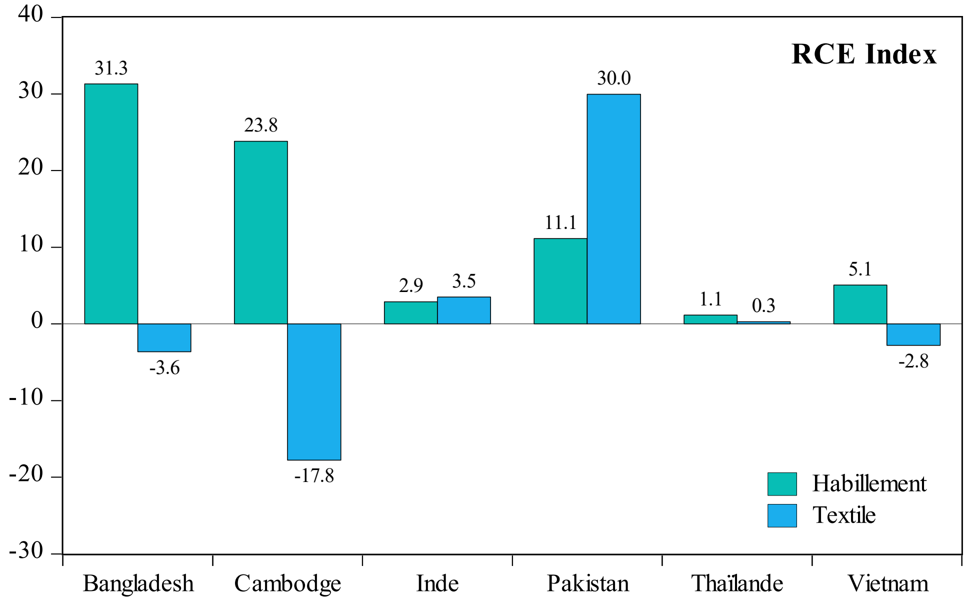
**Figure 1:** RCA Index of Garment and Textile industry over period 2000-2014

Figure 1.1: Revealed Comparative Advantage



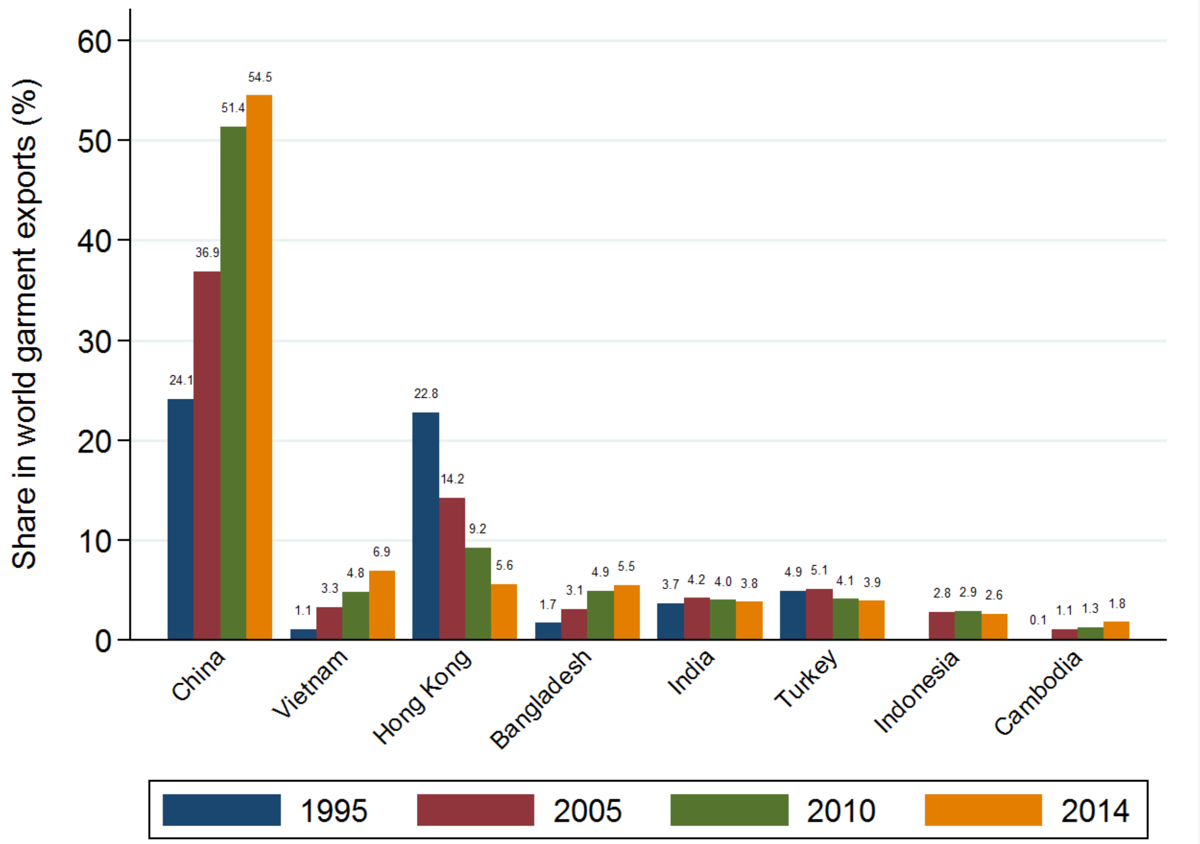

*Source: Analysis of Garment and Textile Industry Competitiveness in Cambodia (El Monineath, 2016).*

Figure 1.2: Revealed Competitive Advantage



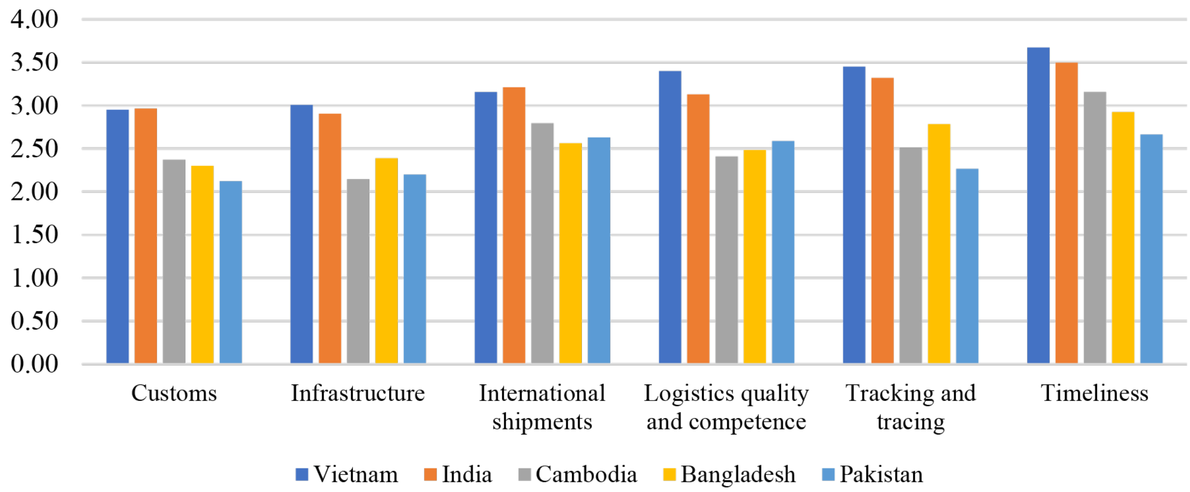

*Source: Analysis of Garment and Textile Industry Competitiveness in Cambodia (El Monineath, 2016).*

**Figure 2:** Main Garment Exporters in the World



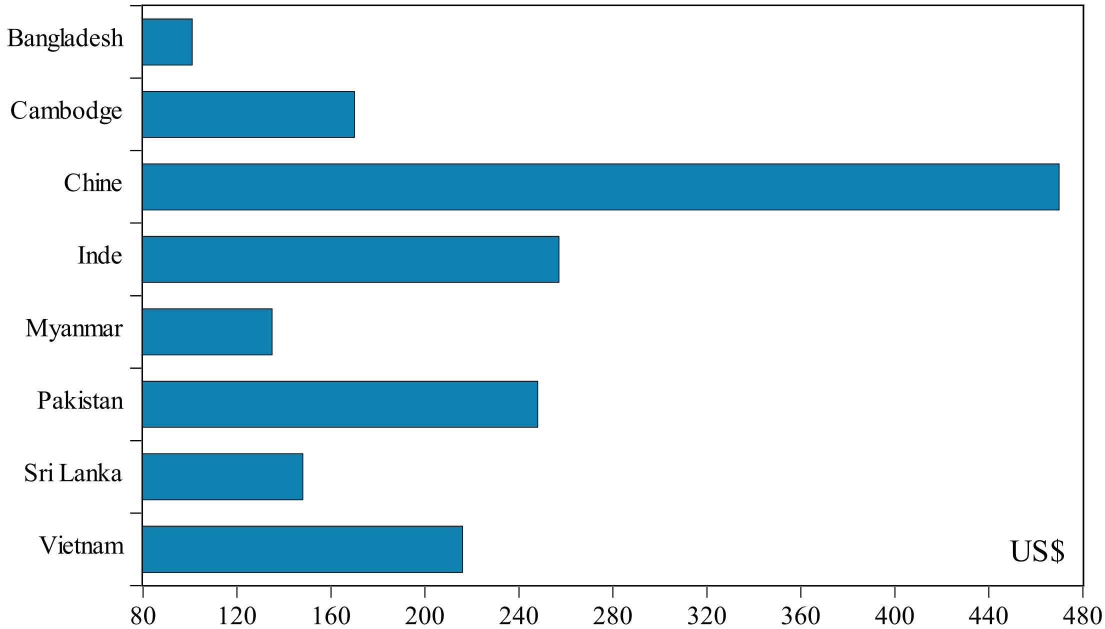

*Source: To Sew or Not to Sew? (Mejía-Mantilla & Woldemichael, 2017)*

**Figure 3:** LPI indicators for India, Bangladesh and Selected East Asian Countries (2018)




Source: Logistic Performance Index, the World Bank, 2018
Logistics performance index: Overall (1=low to 5=high)

**Figure 4:** Monthly wages applicable to the Garment sector of Selected Asian Countries




*Source: Japan External Trade Organization, surveys 2017-2018*