CAMBODIA

CORPORATE SOCIAL RESPONSIBILITY IN THE APPAREL SECTOR
AND
POTENTIAL IMPLICATIONS FOR OTHER INDUSTRY SECTORS

APRIL 2005

Foreign Investment Advisory Service
a Joint Service of the
International Finance Corporation and
The World Bank
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At the request of Ministry of Commerce and the Secretary of State of Commerce of the Government of Cambodia, the Foreign Investment Advisory Services (FIAS), a joint facility of the International Finance Corporation (IFC) and the World Bank, undertook an advisory project based on CSR experience from around the world. The objective of the project was to assist the Ministry of Commerce and the industry to move away from current dependence on a quota-focused strategy towards a more market-led and sustainable strategy.

The project was co-financed by FIAS and the Agence Française de Développement (AFD) who co-financed this study in the context of the implementation of a project for the promotion of the garment sector’s exports in Cambodia, which is made on behalf of the French government program to strengthen trade capacities in developing countries, and is funded by AFD and the French Ministry of the Economy, Finance and Industry.
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<td>-----------------------------</td>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>ASEAN</td>
<td>Association of South-East Asian Nations</td>
</tr>
<tr>
<td>CSR</td>
<td>Corporate Social Responsibility</td>
</tr>
<tr>
<td>EPZ</td>
<td>Export Processing Zone</td>
</tr>
<tr>
<td>FAO</td>
<td>Food and Agriculture Organization</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FIAS</td>
<td>Foreign Investment Advisory Services</td>
</tr>
<tr>
<td>FSC</td>
<td>Forest Stewardship Council</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Products</td>
</tr>
<tr>
<td>GMAC</td>
<td>Garment Manufacturers Association in Cambodia</td>
</tr>
<tr>
<td>ILO</td>
<td>International Labor Organization</td>
</tr>
<tr>
<td>JICA</td>
<td>Japanese International Cooperation Agency</td>
</tr>
<tr>
<td>MFA</td>
<td>Multi-Fiber Arrangement</td>
</tr>
<tr>
<td>MoC</td>
<td>Ministry of Commerce</td>
</tr>
<tr>
<td>MoF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>MoL</td>
<td>Ministry of Labor</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
</tr>
<tr>
<td>PAC</td>
<td>Project Advisory Committee</td>
</tr>
<tr>
<td>PEFC</td>
<td>Pan-European Forest Certification</td>
</tr>
<tr>
<td>RGC</td>
<td>Royal Government of Cambodia</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Program</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-Added Tax</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
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</tbody>
</table>
EXECUTIVE SUMMARY

i. The Multi Fiber Arrangement, or MFA, has governed world trade in the apparel and textile sector since 1974. The quota system artificially inflated the number of countries manufacturing garments for export by restricting the output of the most competitive countries, and importers sourced from one country or another primarily because of quota availability. This led to the development of garment industries in comparatively uncompetitive countries, sheltering them from the rigors of global competition. The consequence for the industry has been global over-capacity and inefficiency.

ii. The Uruguay Round agreement set a ten year phase-out for the MFA. This came to an end on January 1, 2005, eliminating all textile and garment import quotas for WTO member countries. Investors’ and buyers’ decisions no longer need be based on quota availability. They can now source from any country or factory based on its competitiveness, market access, tariff and trade preferences. Most observers expect rapid consolidation of the garment industry globally to the most efficient countries and the most efficient factories, although the transition may well be slowed by the imposition of safeguard measures in both the US and Europe for domestic political reasons.

iii. Cambodia’s garment exports industry began in 1995, with just US$20m exports. By 2004, the country was exporting garments worth $1.6bn. Cambodia's production is less than 1% of the global industry, but has become the biggest hard currency earner in the country, representing 80% of exports and 12.4% of GDP.

iv. Cambodia’s reputation as a "sweatshop-free" country stems from a unique provision in its 1999 Trade Agreement with the US. The US Government committed to consider allocating annual quota bonus if Cambodia could demonstrate improvements in labor standards. The Royal Government of Cambodia, the Garment Manufacturers Association of Cambodia, the US Government and the International Labor Organization agreed an innovative project designed to improve labor standards, monitor improvements, and report on them. Over a five year period, the project succeeded in improving compliance with labor standards and in gaining quota bonus for Cambodian garment manufacturers.

v. With the end of the MFA, the US-Cambodia Agreement became redundant, and the Ministry of Commerce requested FIAS assistance to assist the Government and the industry to re-design the labor standards system away from US Government quota decisions into a market-led strategy.

vi. The first step was to test the assumption that there is an export market niche based on labor standards, combined with the normal criteria of price, quality and speed to market – will sufficient buyers continue to source in Cambodia, not because of market-distorting quota allocation but because they are attracted by the attention paid to labor standards? A survey of Cambodia’s key US and European buyers confirmed the existence of this market niche. Not only did buyers rank compliance as a top priority, but a large majority stated that auditing of labor...
standards would remain crucial. This labor standards advantage was the only issue on which
buyers surveyed believed Cambodia outperforms its regional competitors.

vii. The next step in the advisory project was to work with all stakeholders in redesigning the
existing monitoring and reporting system in a way that integrated international best practice and
re-targeted activities to directly meet the information needs of the industry’s international buyers.
Emerging good practice suggests that the most successful national-level monitoring schemes
aspire to seven characteristics; the first phase of the Cambodia Garment Sector Project met the
first two characteristics and to some extent the third, but not the remaining four:

<table>
<thead>
<tr>
<th>CHARACTERISTICS</th>
<th>ASSESSMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Designed to:</td>
<td></td>
</tr>
<tr>
<td>1. be sector-wide (aiming for 100% of firms)</td>
<td>Yes</td>
</tr>
<tr>
<td>2. be transparent</td>
<td>Yes</td>
</tr>
<tr>
<td>3. have a shared governance structure</td>
<td>No, but shared advisory structure</td>
</tr>
<tr>
<td>4. involve international buyers</td>
<td>No, but starting</td>
</tr>
</tbody>
</table>
| 5. reduce inefficiencies                             | No: buyers duplicated monitoring; Ministry of Labor
                                                      | continued normal inspections                      |
| 6. measure productivity impacts                      | No, but pilot measurement scheme                  |
| 7. achieve market-based incentives                   | No: quota bonus was not awarded to best performing firms |

viii. Based on this assessment, shared by all stakeholders, a strategy was designed that
includes all seven characteristics, builds on Cambodia’s identified first mover advantage with
labor standards, and redirects activities towards meeting the market needs of overseas buyers and
their stakeholders.

ix. The strategy is not to maintain the ILO Garment Sector Project after a transition period,
but instead to sustain and integrate its activities into the way the industry functions. In a similar
way, the current tri-partite Project Advisory Committee (PAC) will be replaced by a tri-partite
governing body¹, mandated to oversee the monitoring, reporting, remediation and promotional
activities, ensuring that they are performed to the highest standards, to hire the Executive
Director of the executing agency and to oversee the process of staff hiring.

x. The scheme, re-branded by the ILO as Better Factories Cambodia, aims to have one
unified labor standards monitoring and reporting system that:
   a) meets the labor standards information needs of all suppliers and buyers;
   b) triggers market responses – positive and negative – and industry self-regulation;
   c) dramatically reduces the current duplicate monitoring and inspections in the garment
      industry;

¹ The tri-partite governing body should still GMAC, the Ministries of Labor and Commerce, and trade unions. The
ILO’s ex officio presence at the PAC should be replaced by full ILO participation on the governing body and
overseas buyers should be consulted through an annual buyers’ consultative forum
d) allows the Ministry of Labor and Vocational Training to refocus its own inspections in the export garment industry on enforcement, conciliation and complaints-based work.²

xi. A summary of the recommendations required to meet this objective is presented below.

<table>
<thead>
<tr>
<th>Area/Sector</th>
<th>Issue</th>
<th>Recommendation</th>
<th>Status</th>
<th>Priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Monitoring and reporting system</td>
<td>Industry participation</td>
<td>Avoiding free-rider problems</td>
<td>MoC issue a prakas requiring all exporting garment factories to register with the project</td>
<td>Agreed but not yet implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>MoC include subcontractors in the monitoring system</td>
<td>Not yet implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>MoC clarify law for EPZ and that the Law will apply in its entirety</td>
<td>Not yet implemented</td>
</tr>
<tr>
<td>II. Reporting and information needs</td>
<td>Outputs of the monitoring system</td>
<td>Responding to stakeholders information needs</td>
<td>RGC assess all Ministries’ inspection information requirements</td>
<td>Not yet agreed</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>ILO systematically assess gaps between buyers’ information needs and current system’s outputs</td>
<td>Agreed and underway</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>ILO discuss options for buyer engagement</td>
<td>Agreed and underway</td>
</tr>
<tr>
<td></td>
<td>Incentives</td>
<td>Reducing the inspection burden</td>
<td>MoL accept outputs of this system; not duplicate and focus on complaints, enforcement and conciliation</td>
<td>Agreed to consider</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>MoC liaise with MOF to solve the problem of VAT acting as a barrier to declaring subcontracting arrangements</td>
<td>Not yet agreed</td>
</tr>
<tr>
<td></td>
<td>Transparency</td>
<td>Ensuring sustained credibility of the system</td>
<td>PAC agree to change advisory committee into tripartite governing body from 1st January 2009</td>
<td>Agreed by all three sectors</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>PAC ensure continued transparency of new information system</td>
<td>Agreed</td>
</tr>
<tr>
<td></td>
<td>Continuous monitoring</td>
<td>MoC commission repeat surveys of buyers sourcing criteria and intentions</td>
<td>Not yet agreed</td>
<td>Medium</td>
</tr>
</tbody>
</table>

² This aspect will require further discussion with the Ministry of Labor, and with colleagues in the ILO. Adequate safeguards will need to be established, but it is hoped that government inspectors will eventually also be able to rely on the monitoring program for these key areas of labor law.
<table>
<thead>
<tr>
<th>Area/Sector</th>
<th>Issue</th>
<th>Recommendation</th>
<th>Status</th>
<th>Priority</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ILO develop pilot indicators to measure improvements in working conditions, quality and productivity</td>
<td>Agreed</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td></td>
<td>ILO and GMAC monitor factory level gains arising from remediation training</td>
<td>Agreed and underway</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Promotion</td>
<td>Marketing the country’s distinctive advantage</td>
<td>PAC agree promotion strategy, including with new Cambodian Investment Board.</td>
<td>Not yet agreed</td>
<td></td>
</tr>
<tr>
<td>II. Financing</td>
<td>Monitoring and reporting system</td>
<td>Ensuring sustainability</td>
<td>PAC agree a shared financing strategy</td>
<td>Agreed</td>
</tr>
<tr>
<td></td>
<td>ILO initiate discussions on creation of market for remediation, capacity-building services</td>
<td>Agreed and underway</td>
<td>Low</td>
<td></td>
</tr>
<tr>
<td>III. Labor market</td>
<td>MoL review labor law as necessary with technical assistance from the ILO</td>
<td>Agreed</td>
<td>Medium</td>
<td></td>
</tr>
<tr>
<td></td>
<td>MoL and GMAC consider need for labor adjustment services during the expected shake-up</td>
<td>Not yet agreed</td>
<td>Medium</td>
<td></td>
</tr>
</tbody>
</table>

xii. As a final step in this advisory project, the Ministry of Commerce requested FIAS to briefly consider the potential implications of the garment sector’s labor standards focus for other industry sectors. Because of their importance in terms of GDP, employment or growth potential, the sectors reviewed include tourism, agribusiness, forestry, oil and gas. Two issues were considered: first, the potential competitive advantage of labor and environmental standards in these sectors; second, the potential instruments at the Government’s disposal to encourage comparable good practice.

xiii. The analysis and examples of good practice in section IV reveal that systems and tools very similar to those established in the garment industry could be implemented in other industries. In all four sectors, setting national standards, putting in place credible monitoring and certification structures and institutions; facilitating access to finance; recognizing international certification schemes as equivalent to public sector inspection; monitoring; working under shared governance systems; etc. are among the common tools that can support the Government’s vision of a country committed to labor and environmental standards, building on the existing structure and experience gained from the garment sector.
CHAPTER I
BACKGROUND

A. Cambodia’s economic performance

1. Cambodia is a land of paddies and forests, dominated by the Mekong River and Tonle Sap. Forty percent of GDP is still from agriculture, with 80% of the labor force working on agriculture. Economic activity regained vitality in 1999, supported by inflows of development aid – currently running at about 60% of the annual budget. The government’s macroeconomic strategy yielded positive results, with GDP growth averaging 7% per annum during 1999-2001, and subdued inflation. But GDP growth slowed to 4.4% in 2003, demonstrating the urgent need for parallel reforms at the micro-economic level. Some progress has been made in strengthening customs and tax administration, restructuring the banking system and introducing various legislative changes; however, deep-rooted governance problems and human resources constraints remain. The foundations to support growth remain weak; the population lacks education and productive skills, infrastructure is poor, and the regulatory environment is unpredictable.

2. Cambodia joined the WTO in September 2004, the first least developed country to join. Cambodia remains one of the poorest countries in the world, ranking 130th out of 173 in the Human Development Index, with the second lowest life expectancy among its neighbors, Thailand, Vietnam and Laos.

3. FDI into Cambodia has been declining. Table I.1 below summarizes FDI inflows for the period 1998 to 2003:

<table>
<thead>
<tr>
<th>Year</th>
<th>Value (US$ Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>243</td>
</tr>
<tr>
<td>1999</td>
<td>230</td>
</tr>
<tr>
<td>2000</td>
<td>149</td>
</tr>
<tr>
<td>2001</td>
<td>149</td>
</tr>
<tr>
<td>2002</td>
<td>145</td>
</tr>
<tr>
<td>2003</td>
<td>87</td>
</tr>
</tbody>
</table>

4. The garment sector (textiles and garments) eclipses all other foreign investments in terms of the number of active projects. Projects have also been implemented in the food and agricultural processing sector. Other sectors become significant when the value (rather than the number) of investments is considered; these include infrastructure-dependent sectors such as transportation. Tourism and hotels, services and wood processing have also attracted significant

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FDI by value. But the garment sector dominates; almost no other country in the world is as
dependent on one industry sector for FDI inflows, GDP growth, jobs and exports.

B. End of the Multi Fiber Arrangement and implications for Cambodia

5. The garment sector is the classic footloose export sector, requiring relatively little capital
investment or workforce training, and seeking locations with low cost labor to supply product
competitively into the world market. Textiles and clothing is a $395 billion industry worldwide,
employing more than 24 million workers in 200 countries. The Multi Fiber Arrangement, or
MFA, has governed world trade in the apparel and textile sector since 1974, providing the basis
on which industrialized countries restricted imports from developing countries, to protect their
domestic textile manufacturers. Quotas were negotiated each year on a country by country basis,
assigning the quantity of specified items that could be exported from individual developing
countries to individual developed countries. The objective was to protect domestic industries in
developed countries, but the MFA quotas also provided many developing countries with access
to markets and protection from the rigors of global competition. The quota system artificially
inflated the number of countries manufacturing garments for export by restricting the output of
the most competitive countries, and importers frequently moved from one country to another
solely because of quota availability. In consequence, the global industry developed over-capacity
and inefficiency.

6. The Uruguay Round agreement set a ten-year phase-out for the MFA. This came to an
end on January 1 2005, eliminating all textile and garment import quotas for WTO member
countries. Most observers now expect rapid consolidation of the garment industry globally to the
most efficient countries and the most efficient factories.

7. However, three major instruments look set to retain importance in the post-quota world:
   • anti-dumping and safeguard measures linked to China’s accession to the WTO that
     permit importing countries to re-impose quotas until 2008 if deemed necessary to prevent
     “market disruptions”\(^4\);
   • import tariffs which add an average 12% to garment import prices;
   • bilateral agreements or systems of preferences.

8. As of April 2005, it appears that both the US and Europe are contemplating the use of
tariffs and safeguards quotas, in an attempt to slow China’s apparel exports. The US Commerce
Department has launched a probe into whether China’s burgeoning sales are disrupting the US
market\(^5\); Trade Relief Assistance for Developing Economies (TRADE) will offer tariff
preferences on textile products to some poorer countries in the Asia-Pacific area; and the EU has
excluded China and India from the countries included in its revised Generalized System of

\(^4\) under the terms of the agreement governing China’s accession to the WTO, member countries are entitled to apply
the safeguard provision (i.e. re-impose quotas on a category-by-category basis) until December 2008 and can apply
a standards WTO safeguard mechanism (anti-dumping provisions, come-back of voluntary export restraints, …)
selectively targeting China for more limited reasons up to 2013.

Preferences (GSP). These decisions all seem to show that the garment sector may not yet have entered the era of competitive forces determining winners and losers.

9. But buyers will now be free to go where they can get the best price, delivery and quality, and where it is easiest to do business. Buyers want to visit the manufacturer and discuss requirements with professional managers. They want to be given prices on the spot, including all costs. They want the manufacturer to offer suggestions on style and construction as well as be able to carry out dyeing, finishing, embroidery and screen printing. Countries that can not do this as a total service to buyers will not be part of the global garment supply chain for much longer.

10. Cambodia urgently needs to upgrade its industry and diversify its sources of growth, but the immediate question is whether the garment sector will survive. Buyers will not source 100% of their needs from China, and will spread their risk by sourcing from other countries, The Royal Government of Cambodia (RGC) and the Garment Manufacturers Association of Cambodia (GMAC) believe that Cambodian factories’ reputation for strong labor standards may give them a comparative advantage in this highly competitive marketplace. The Ministry of Commerce therefore requested FIAS assistance to advise the Government and the industry on re-designing their existing labor standards system away from US Government quota decisions into a market-led strategy. Working closely with the Ministry of Labor and the International Labor Organization (ILO), the FIAS advisory project sought to design marked-based solutions for improved sustainability in the garment sector, as well as consider potential implications of this comparative advantage for other industry sectors.

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CHAPTER II

CORPORATE SOCIAL RESPONSIBILITY AND GLOBAL SUPPLY CHAINS

11. Corporate Social Responsibility, or CSR, is defined as operating a business in a manner that meets or exceeds legal and societal expectations, fostering both business benefits and positive development impact. CSR covers a wide range of business activity, but everything centers on business voluntary efforts to improve social and environmental standards. (The distinction with corporate philanthropy is straightforward: CSR concerns the way a business is managed, philanthropy concerns the way business profits are allocated).

12. In the early 1990s, production outsourcing from developed countries increased at the same time that communication technologies were becoming increasingly global. A number of well publicized sweatshop scandals increased concerns about the conditions under which internationally outsourced goods and services were being produced. Many multinational corporations responded by designing voluntary codes of conduct that specified the social and environmental standards they wanted to see applied right through their supply chain, no matter where production was taking place. In almost all cases, the standards within these codes were higher than those that were being enforced at that time in developing country factories.

A. Code implementation

13. Sustained implementation of codes of conduct has helped ensure an effective compliance regime, which has contributed to improving factory working conditions and relationships with surrounding communities. This has in turn helped host governments ensure their national legislation is effectively enforced within factories. Good standards also appear to make good business sense. At the level of the supplier factory, there is a growing evidence of a positive link between good labor management and increased productivity, improved quality through a reduced number of defects, lower employee turnover and absenteeism and a lower number of accidents. At the level of international buyers, the risk of negative publicity over child labor, for example, is mitigated, while an increasing number of premium brands are seeking to differentiate themselves in the consumer marketplace by including some concept of guaranteed production standards in their brand image.

14. The apparel and footwear industries were among the first to take the lead in using CSR as a minimalist mitigation strategy against negative publicity. They were among the first to adopt voluntary codes of conduct, and to develop mechanisms for monitoring, third party inspections, reporting, and the adoption of remediation systems and training programs for supplier factories. Each major international buyer typically implemented such systems down their individual supply chains, requiring sourcing factories to participate.

15. These activities have gained momentum over the last 15 years. Private inspection industries, labeling programs, and multi-stakeholder initiatives have multiplied. CSR practices
and compliance with codes of conducts – of varying standards – are now seen as a prerequisite to doing business with most major international buyers. Costs are higher, for both buyers and suppliers; benefits are often assumed rather than measured; duplication and inefficiencies are widespread, since most apparel factories sell to multiple buyers, each requiring their individual code to be implemented, monitored and inspected. And all of this monitoring activity happens alongside the inspection regime of host government Ministries of Labor and Environment.

16. A small but growing number of national governments are now beginning to recognize two things. First, that CSR systems can help them get their own labor and environment laws enforced within factories supplying international buyers with codes of conduct; hard-pressed public sector inspectorates, knowing these parallel systems are being implemented in major factories, can focus their limited inspection resources on factories supplying the domestic market where standards are typically much lower, or on other industries where CSR codes are not implemented. Secondly, national governments are realizing that guarantees of good labor standards can help their national economic competitiveness strategy, since evidence of good standards is increasingly required by buyers, investors and project financiers, and is increasingly included in free trade agreements or systems of trade preferences.

17. Governments have been following this innovative strategy in a number of different ways, ranging from self evaluation (box II.1) to certification (box II.2). These forms of public-private collaboration present opportunities for achieving better and more comprehensive enforcement by capitalizing on private sector incentives: in each of these cases, the firm’s motivation is the anticipation of market reward, since these voluntary monitoring and certification schemes are typically required or appreciated by international buyers.

Box II.1: Private sector self-assessment of labor standards compliance

In 2002, the Philippines Department of Labor and Employment adopted a new framework for labor standards enforcement in the country's enterprises, combining voluntary and regulatory approaches.

The framework ensures compliance with labor standards through self-assessment, inspection and advisory services. All enterprises with more than 200 workers are required by law to carry out self-assessment of the workplace environment. Assessments are carried out once a year by a joint team of representatives of labor and management on the basis of checklists provided by the government. Workers can complain to the government if they disagree with the assessment submitted by management. The Bureau of Working Conditions carries out random spot visits. Management and workers can be expected to develop a better working relationship as they find means for addressing both labor and productivity issues.

Poor workplace conditions are more frequently widespread in small and medium-sized enterprises, and the new approach allows the public sector to focus on these enterprises where conditions are likely to be poor.

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Box II. 2: Voluntary Certification in place of public sector inspection

The Bolivian 1996 Forest Law stipulates that forestry concessionaries holding a regularly renewed voluntary international forest certification of good standards are exempt from the Ministry’s own audit, which is normally required every five years to get licenses renewed.

In the state of Karnataka, India, companies that have chosen to get ISO 14001-certified are exempt from some state environmental emission charges.

18. In early 2004, a number of brands and retailers, international institutions, trade unions and NGOs known together as the ‘MFA Forum’ came together internationally to better understand the implications of the end of the MFA, particularly for workers and communities, and to explore how best to promote collaborative approaches to mitigating negative impacts and taking advantage of new opportunities. Several pieces of research have been the specific outputs of the Forum’s work to date, intended to raise awareness and facilitate dialogue and action. They recognized “that a failure to responsibly handle the transition to a post-MFA world carries several dangers:

- Foremost is the negative impact on workers, communities and local and national economies of losing critical employment and earnings potential.
- Damage to the reputations of business as well as other institutions in not addressing negative impacts on workers, and resulting decline in trust and active collaboration with business in addressing the social and environmental dimensions of the sector.
- The erosion of trust in the broader agenda of development through trade.”

19. The MFA Forum concludes that the dangers can be addressed most effectively by action at several levels:

   a) promoting enabling public policy, for example in the sphere of trade;
   b) building strategic supply chain partnerships that balance social and commercial interests; and
   c) mitigating negative social consequences of sector restructuring e.g. compensation, promoting employment opportunities, and retraining.

20. A number of such schemes exist in different countries, encouraged by national Governments. Emerging good practice typically involves the following seven characteristics (Box II.3):

---

8 Managing the Transition to a Responsible Global textiles and Garment Industry; The MFA Strategic Sourcing Impact – the Private Sector Perspective; Mapping the End of the MFA; all available from www. AccountAbility.org
Box II.3: Good practice characteristics in national-level CSR standards schemes

Designed to
1. be sector-wide (aiming for 100% of firms in the sector), since one bad apple can ruin a country’s reputation for all firms
2. be transparent
3. have a shared governance structure
4. involve international buyers
5. reduce inefficiencies (duplication of monitoring) among both public and private inspections
6. measure productivity gains systematically, including firm-level baselines
7. achieve market-based incentives

B. Labor standards and economic development

21. Adherence to labor standards can contribute to a country’s overall economic and social development, as well as expanding market access. The link between development and labor standards has been examined most closely for a subset of ‘core’ labor standards: progressive elimination of child labor; ban on forced labor; non-discrimination in employment; and freedom of association and the right to collective bargaining. These standards enjoy very strong international support.\(^9\) Economic evidence discussed in Box II.4 and below, also suggests the importance of these as national economic policy priorities.

Box II.4: Economic Theory and Evidence Related to Core Labor Standards

**Forced labor:** In addition to the compelling moral and human rights concerns, forced labor reduces human capital development and erodes national competitiveness.

**Child Labor:** Child labor reduces human capital development (health & education), reduces future earnings, and is significantly related to intergenerational transmission of poverty. The ILO (2004) estimates the present value of the economic gain to eliminating child labor worldwide to be in the order of US$5 trillion over the 2000-2020 period.

**Discrimination:** Discrimination in employment and pay creates inefficiencies and impedes economic growth by underutilizing and misallocating human capital resources. It also can exacerbate poverty among already-vulnerable groups including women and ethnic and religious minorities

**Freedom of association and collective bargaining:**\(^{10}\) No significant correlation with growth or productivity. Many studies show that unions reduce income inequality (Aidt and Tzannatos, 2002). Little evidence from developing countries.

---

\(^9\) As of March, 2005, 105 states had ratified all eight core conventions; an additional 29 had ratified seven of eight; and 14 more had ratified six.

\(^{10}\) Understanding the development impacts of these rights is more complicated because there are many different types of unions (varying degrees of independence from government or company interference, etc.) and ways to organize collective bargaining (firm, sector, nationwide level) all of which can influence the economic outcomes. Also, research has almost always measured the *observed impacts* of unions and collective bargaining which is somewhat different than measuring the *impacts of a policy environment that enables* freedom of association and collective bargaining. Finally, the research often comes from OECD countries and there is little evidence about the role of unions in low-income countries.
22. Collectively, compliance with core labor standards is correlated with higher national income. At least one study has also found that the rates of economic growth are higher for countries with good or medium level of core labor standards, with stronger effects for developing countries (Bazilleir, 2004). There is also evidence that low labor standards can erode national competitiveness by reducing incentives for human capital investment. Higher labor standards provide firms incentives to invest in productivity-enhancing training to justify the expense of complying with the standards (Block, Roberts, Ozeki, and Roomkin, 2001). Likewise, workers have an incentive to improve their skills, as there are opportunities for higher wages when minimum standards are respected. Low wages as the result of repression of core labor standards will also reduce incentives for firms to adopt labor-saving technology, thereby limiting the productivity and growth potential of firms in low standard countries.

23. Studies do not find that foreign direct investment favors low standard economies or that such countries have higher aggregate exports (OECD, 1996, 2000; Kucera, 2001). The World Bank has also concluded that many East Asian countries have room for improvement in protecting fundamental worker rights and advises that doing so would not negatively impact competitiveness in labor-intensive exports (World Bank, 2003).

24. Standards beyond this core set of basic worker rights, sometimes referred to as “cash standards” such as minimum wages, mandatory benefits (e.g. canteens, health centers), hours of work, and occupational safety and health standards, may more directly affect labor costs. Here, the evidence is mixed and the outcomes depend very much on the level at which the standards are set. Though under-studied in poorer countries, occupational safety and health provisions tend to be beneficial. The costs of work-related accidents and illnesses in OECD countries are estimated between 2 and 4% of GDP.

25. Some international evidence indicates that regulations which significantly limit employers’ decisions in hiring and letting go of workers tend to be associated with a less dynamic labor market and lower aggregate employment levels and higher informal employment (Betcherman, Luinstra, and Ogawa, 2001). Low income countries that have not established good mechanisms for income support or social safety nets outside the firm tend to regulate this employment relationship more strictly. When enforced, these provisions can benefit workers who are employed and covered by the legislation, but it may come at the cost of total employment. On the other hand, many have argued that employment protection rules can strengthen worker’s attachment to firms and skill development, which could reduce costs.

26. CSR advocates and many leading companies have argued that improving working conditions can have firm-level benefits beyond accessing or expanding orders from reputation-sensitive buyers. Many anecdotes support this argument in favor of a business case, but relatively few rigorous studies have analyzed the impact of labor standards compliance on firm level indicators such as productivity and profitability.12

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11 Baziller finds a non-linear relationship between standards and growth, with little effect on growth for countries with either very high or very weak labor standards.

12 A number of rigorous studies are currently underway, including one in Cambodia on the determinants of labor productivity sponsored by USAID. At least two methodological problems complicate this type of analysis: (1)
27. A number of factories that have voluntarily improved working conditions in order to attract buyers often report other benefits. For example, a state owned textile factory in Vietnam reported a 5% increase in productivity after achieving certification under the Social Accountability 8000 standard. A private apparel firm also operating in Vietnam enjoyed a 20% increase in profits following investments in improving labor standards.\textsuperscript{13} Participants in the ILO Factory Improvement Program in Sri Lanka were found to reduce end line defects from 13% to 8%. Worker absenteeism went down from 8% to 5% and turnover from 9% to 7%. Factories involved in an adapted version of the Sri Lanka program piloted in Cambodia reported impressive results in quality and productivity gains; one factory reported a 67% drop in turnover, 48% improvement in productivity and 16% increase in wages.

\textsuperscript{13} Results of both factories reported at CSR conferences in Hanoi and Ho Chi Minh City, December 2002.

\textsuperscript{9}

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Difficulty in identify labor standards as cause of factory improvements when many other changes could be taking place at the firm (Co-linearity) and 2. The “Hawthorne Effect” which stipulates that any change temporarily improves productivity, as workers and supervisors are aware of the increased attention on them.
28. Cambodia’s garment exports industry began in 1995, with US$20m exports. The industry grew rapidly as result of favorable trade agreements signed in 1996 with the EU and in 1999 the US, since preferential access to exports markets is a significant factor in the location choice for the garment industry (figures III.1 and III.2). In 1998, garment exports were $378m; by 2004, Cambodia had 220 garment factories employing 260,000 workers, exporting garments worth $1.6bn for brand names such as The Gap, Banana Republic and Polo. Cambodia's garment industry represents less than 1% of the global industry, but has become the biggest hard currency earner in the country, representing 80% of exports and 12.4% of GDP.

Figure III.1 – From 2000 to 2004 exports to the US rose by 57%

![Graph showing US Garment Imports: Cambodia]

Source: AccountAbility, *Managing the End of the MFA*, November 2004

Figure III.2: From 2000 to 2003, exports to the EU rose by 83%

![Graph showing EU Garment Imports: Cambodia]

Source: AccountAbility, *Managing the End of the MFA*, November 2004
29. With over 270,000 workers, the garment sector is the largest source of formal wage employment in the country. It is a particularly important job source for women who make up 84% of employment in the sector. Work in the garment industry offers women higher incomes and better working conditions than are available to them elsewhere in the economy where their mostly likely alternative employment is as an unpaid worker on a family farm or in the informal sector. Sizeable remittances from garment workers, up to half their monthly salary, support up to a million people in rural areas. Research supported by the Asian Development Bank (ADB) indicates that garment worker remittances has reduced food insecurity in the sending villages from eight months of the year to two months.

30. Cambodia’s reputation as a "sweatshop-free" country stems from a unique provision in its trade agreement with the US. Starting in 1999, under the terms of the US-Cambodia Trade Agreement, the US Government committed to increase the size of Cambodia’s quota by 18% per annum if the country could demonstrate improvements in labor standards. This was the first bilateral trade agreement to positively link progress in compliance with labor obligations. Alongside the agreement, the Royal Government of Cambodia (RGC), the Garment Manufacturers Association of Cambodia (GMAC), the US Government and the International Labor Organization (ILO) agreed an innovative project designed to improve labor standards, monitor improvements, and report on them in a manner that would satisfy US requirements. Unique features of the scheme were its transparency, and the involvement of all garment factories.

31. The ILO project succeeded in improving compliance with labor standards over a five year period, as documented in the nine synthesis reports completed to date, virtually eliminating the worst labor abuses such as forced labor and child labor. These improvements in labor standards compliance are a hopeful sign for Cambodia, both in terms of the intrinsic value of better protection for workers, but also as a demonstration of effective governance. However, there remain serious areas of labor standards violations and deficiencies in governance. Working conditions in factories not subject to monitoring, such as those factories that are subcontracted by exporting firms, are likely far worse in the monitored firms. If the scale of subcontracting significantly increases, as is a possible implication of the churning expected in the wake of the MFA, allowing these firms to remain uncovered by the monitoring program risks both the well-being of the workers in these facilities and the reputation of Cambodia as a safe sourcing location for reputation-sensitive buyers.

**Box III.1: Trade Unions in the Cambodian Garment Sector**

The growth of the garment sector and the democratic transition in Cambodia has prompted the emergence of an active trade union movement in the country. A September 2004 survey of trade unions in Cambodia estimated total union membership in the country at 337,000, of whom 83% are women. The largest number of union members and unions are found in the garment industry, where 10 union federations compete for members.

The various federations are grouped into two main factions. Locally known as *Group A*, the Cambodian Confederation of Trade Unions (CCTU) consists of 9 federations that are loosely allied to the governing political party. *Group B* federations Confederation of Free Democratic Trade Unions of Cambodia (CFDTUC) consist of 4 federations that are broadly independent or loosely allied to the opposition party.
Despite this seemingly major split, the unions have developed a workable system of coming to agreement on workplace issues. In the garment industry, they have developed a common proposal for a framework collective bargaining agreement which promises no strikes in exchange for the employers accepting binding arbitration from the Arbitration Council for labor disputes. The unions have submitted the proposal to GMAC.

The ILO Survey found that the key membership issues are low wages, safety and health, and job security. Union leaders worried most about employer attitudes, government capacity, finance and competition with other unions.

32. Discrimination and, in the worse cases, violence, against union members still occurs and with a regrettable degree of impunity in Cambodia. There is considerable room for improvement in cooperation and bargaining between unions and employers, as well in relations between the unions, employers, and the government. Further capacity building in cooperative industrial relations and dispute resolution is needed for workers, unions, employers, and the government.

33. However, it was the transparent monitoring scheme that succeeded in raising labor standards, and the end of the MFA has made the scheme’s key incentive redundant. Quota has been eliminated, and there is no more quota bonus as a reward for improved standards. Furthermore, a consolidation of garment manufacturing to a smaller number of countries with the strongest competitive position is now starting, post-MFA. Cambodia has lost its quasi-guaranteed quota market access into the USA, and must now compete aggressively with exporters such as China, Pakistan, Bangladesh and India. During 2004, a large number of projections were made of apparel sourcing trends post-MFA: all anticipated increased market share going to China (figures III.3 and III.4); these projections have been born out by early data from the first quarter of 2005.
Figure III.3: Market shares before and after quota elimination, Clothing, EU


Figure III.4 – Market shares before and after quota elimination, Clothing, US

The combination of labor standards and innovative incentives in the US Trade Agreement gave Cambodia a market advantage. The first step in this advisory project was to test the assumption that there is an export market niche based on labor standards, combined with the normal criteria of price, quality and speed to market – will sufficient buyers continue to source in Cambodia, not because of market-distorting quota allocation but because they are attracted by the attention paid to labor standards?

A. Survey of buyers intentions

In mid 2004, FIAS surveyed key 2004 international buyers from Cambodia about three issues:

(a) their sourcing criteria;
(b) their perception of Cambodia’s performance on these issues relative to regional competitors (Thailand, Bangladesh, China, and Vietnam);
(c) their sourcing plans from Cambodia post-MFA.

Fifteen of the largest US and EU buyers, together accounting for 45% of Cambodia’s garment exports, were interviewed using one-on-one structured interviews. Senior sourcing staff, rather than CSR staff, were targeted in order to avoid any bias towards CSR. Interviewees understood the survey to be about apparel competitiveness and were not initially aware of the CSR focus.

1. Sourcing criteria

To determine the importance of labor standards relative to a number of sourcing criteria, buyers were asked to rate the importance of 12 country-specific sourcing criteria and 9 factory-specific criteria on a scale of 1 (no importance) to 5 (critical importance). At the country level, buyers globally ranked labor standards first, followed by trade preferences (including quota and
tariff reductions, etc.) and access to materials and supplies (figure III.5). At the factory level, buyers listed price, health and safety practices, and quality as their top considerations (figure III.6).

2. Perception of Cambodia’s performance

38. Rating of the performance of specific countries on each of the sourcing criteria listed, shows that buyers consider Cambodia (3.65) to have an advantage over Bangladesh (2.35), Thailand (3.13), Vietnam (2.64) and China (2.87) on labor standards. They also consider Cambodia to outperform competitors over tariff preference and union rights (figure III.7) while ranking less well on access to international materials and supplies; political and economic stability; and customs efficiency (figure III.8).

Figure III.7: Country level strengths

<table>
<thead>
<tr>
<th>National level : Cambodia’s strengths</th>
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<tbody>
<tr>
<td>Labor standards</td>
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<td>Tariff preferences</td>
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<td>Union rights</td>
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<td>Importance</td>
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<th>Importance</th>
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<tbody>
<tr>
<td>Cambodia</td>
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<td>Bangladesh</td>
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<td>Thailand</td>
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<td>Vietnam</td>
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<td>China</td>
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Figure III.8: Country level weaknesses

<table>
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<th>National level : Cambodia’s weaknesses</th>
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<tbody>
<tr>
<td>Access to international materials and supplies</td>
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<tr>
<td>Political and economic stability</td>
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<tr>
<td>Customs efficiency</td>
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<td>Importance</td>
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<tr>
<td>Thailand</td>
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<tr>
<td>Vietnam</td>
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<tr>
<td>China</td>
</tr>
</tbody>
</table>

39. At the factory level, buyer felt Cambodia’s strengths include the level of health and safety practices, workforce skills and productivity and product quality. But on none of them did Cambodia rank highest. Buyers saw its weaknesses as price/production costs, production capacity and the range of services offered.

3. Sourcing intentions

40. Survey results showed that key overseas buyers from Cambodia's garment industry currently plan to retain or increase their purchasing – not withdraw, as many Cambodian factory owners fear. 60% of the buyers interviewed said they plan to increase their garment purchases from Cambodia and 40% said they will “wait and see”. None had plans to buy less.

41. Of the buyers interviewed a greater number of European buyers (83%) plan to increase than American buyers (37%) who tend to have more a “wait and see” attitude. The buyers who said that they will increase orders generally have a very low level of orders in constrained categories, challenging the assumption that Cambodia may not be competitive post-MFA.
4. Challenges and opportunities

42. Asked about the key challenges facing Cambodia’s industry at the end of the quota system, buyers mentioned the need to balance increased labor standards with competitive prices and labor costs, against an intensified competition from China. Improving productivity, infrastructure, the level of education and skills of workers, the sourcing of raw materials and the speed to market while reducing corruption were cited as important issues to address to improve Cambodia’s competitiveness.

43. Cambodia ranked fairly well on quality, but has progress to make on price and delivery lead times if it is to be competitive in the post-MFA world. Buyers were insistent that compliance with labor standards is not sufficient for the Cambodian garment industry to survive and grow (figure III.9). Seventy-five percent of buyers surveyed said that red tape, corruption and high energy costs must also be tackled, if production costs are to be competitive.\footnote{The private sector estimates that unofficial payments cost firms an average of 5.2\% of total sales revenue. Because garment production costs in China are estimated to be 15-20\% lower than in Cambodia, corruption and other costs of doing business can render Cambodia uncompetitive. World Bank, Cambodia Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy, August 2004.}

44. The survey results confirm the existence of a market niche that cares about labor standards. Not only do buyers rank compliance as a top priority but an overwhelming 79\% stated that auditing of labor standards remains crucial after January 2005.\footnote{Global survey results concur with 71\% of respondents ranking CSR equally or more important compared to cost, quality, and delivery time. Berman Jonathan E. and Tobias Webb, Race to the Top: Attracting and enabling Global Sustainable Business – Business Survey report, World Bank Group, October 2003} This labor standards advantage is the only issue on which buyers surveyed believe Cambodia outperforms its regional competitors.

45. The first phase of this advisory project therefore confirmed the Government’s hypothesis about the potential market niche, although three issues need to be emphasized:

- surveys of future intentions are never completely accurate;
- all buyers surveyed stressed that continued CSR standards alone would not be sufficient;
- Cambodia’s advantage is a temporary first mover advantage, rather than a permanent comparative advantage: if this strategy succeeds, other countries will surely follow Cambodia’s lead.

\begin{figure}[h]
\centering
\includegraphics[width=0.5\textwidth]{figureIII9.png}
\caption{Labor as the comparative advantage for Cambodia}
\end{figure}
B. ILO Garment Sector Project 2000-2005\textsuperscript{16}

46. The ILO Garment Sector Project was established in 2000 “to reduce poverty by expanding decent work opportunities in the garment export industry”\textsuperscript{17}. The Project has been used over the past four years to provide credible information regarding firm level compliance with Cambodian labor law in order to trigger increased US quota allocations. More specifically, its role has been to:

- provide assistance in drafting new laws and regulations as a basis for improved working conditions;
- build the capacity of Government officials to ensure greater compliance with core labor standards and Cambodian labor laws;
- train Government officials, labor inspectors, employers and trade unions on the content of the law and on the role they can play in implementing it;
- undertake monitoring visits to garment factories, and produce quarterly public reports on their findings, the results of which the U.S. Government considers when making its annual decision regarding whether to grant Cambodia a quota increase.

47. Factory registration with the Project was voluntary, but encouraged by a Ministry of Commerce Prakas, or implementing decree that only factories registered with the Project would be eligible to use or buy quota for the export of textiles to the USA. This registration system did not appear to require participation from factories which produce under subcontracting arrangements for another enterprise which subsequently exports the subcontractor’s production. 243 enterprises were registered with the Project, consistent with the number of enterprises registered with the Ministry of Commerce.

C. Assessment of existing scheme

48. In Chapter II box II.3, we identified the seven characteristics of emerging good practice in national-level schemes to respond to CSR challenges in global supply chains.

\textsuperscript{16} For a complete version of the Aide-Mémoire, see http://www.ifc.org/ifcext/economics.nsf/AttachmentsByTitle/Cambodia+FIAS+Aide+Memoire/$FILE/Cambodia+FIAS+Aide+Memoire.pdf

\textsuperscript{17} ILO Concept Proposal, November 2004, p.2
When we assessed the initial ILO project against this list, we found as follows:

Table Box III.1.: Assessment of existing scheme’s characteristics

<table>
<thead>
<tr>
<th>CHARACTERISTICS</th>
<th>ASSESSMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Designed to</td>
<td></td>
</tr>
<tr>
<td>1. be sector-wide (aiming for 100% of firms)</td>
<td>Yes, through prakas</td>
</tr>
<tr>
<td>2. be transparent</td>
<td>Yes, the most transparent in the world</td>
</tr>
<tr>
<td>3. have a shared governance structure</td>
<td>No, but a shared advisory structure</td>
</tr>
<tr>
<td>4. involve international buyers</td>
<td>No, but starting</td>
</tr>
<tr>
<td>5. reduce inefficiencies</td>
<td>No: buyers did duplicate monitoring; Ministry of Labor continued normal inspections</td>
</tr>
<tr>
<td>6. measure productivity gains</td>
<td>No: systematic baseline not measured; pilot measurement scheme</td>
</tr>
<tr>
<td>7. achieve market-based incentives</td>
<td>No: quota bonus was not awarded to best performing firms</td>
</tr>
</tbody>
</table>

49. This assessment was shared by the ILO team, as well as by GMAC. It fed directly into the proposed redesign of the scheme that was undertaken collaboratively with the ILO and all stakeholders: the Government, GMAC, the unions and, where possible, international buyers.

D. Recommendations

50. This package of recommendations was presented in an Aide Memoire to the Government and all stakeholders in January 2005. The objective was to build on Cambodia’s identified first mover advantage with labor standards, by redirecting activities away from triggering quota bonus decisions by US civil servants and politicians, towards meeting the market needs of overseas buyers and their stakeholders. The recommendation is not to maintain the ILO Garment Sector Project after 2008, but instead to sustain and integrate its activities into the way the industry functions.

51. The recommended strategy is to have one unified labor standards monitoring and reporting system that:

a) meets the labor standards information needs of all suppliers and buyers;
b) triggers market responses – positive and negative – and industry self-regulation;
c) dramatically reduces the current duplicate monitoring and inspections in the garment industry;
d) gives the Ministry on Labor and Vocational Training the opportunity to refocus its own inspections in the export garment industry more closely on conciliation, enforcement and complaints-based work.
<table>
<thead>
<tr>
<th>Area/Sector</th>
<th>Issue</th>
<th>Recommendation</th>
<th>Status</th>
<th>Priority</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Monitoring and reporting system</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry participation</td>
<td>Avoiding free-rider problems</td>
<td>MoC issue a prakas requiring all exporting garment factories to register with the project</td>
<td>Agree but not yet implemented</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MoC include subcontractors in the monitoring system</td>
<td>Not yet implemented</td>
<td>High-Medium</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MoC clarify law for EPZ and that the Law will apply in its entirety</td>
<td>Not yet implemented</td>
<td>Medium-Low</td>
</tr>
<tr>
<td><strong>II. Reporting and information needs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outputs of the monitoring system</td>
<td>Responding to stakeholders information needs</td>
<td>RGC assess all Ministries’ inspection information requirements</td>
<td>Not yet agreed</td>
<td>Medium</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ILO systematically assess gaps between buyers’ information needs and current system’s outputs</td>
<td>Agreed and underway</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ILO discuss options for buyer engagement</td>
<td>Agreed and underway</td>
<td>Medium</td>
</tr>
<tr>
<td>Incentives</td>
<td>Reducing the inspection burden</td>
<td>MoL accept outputs of this system; not duplicate and focus on complaints, enforcement and conciliation</td>
<td>Agreed to consider</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MoC liaise with MOF to solve the problem of VAT acting as a barrier to declaring subcontractors</td>
<td>Not yet agreed</td>
<td>Medium</td>
</tr>
<tr>
<td>Transparency</td>
<td>Ensuring sustained credibility of the system</td>
<td>PAC agree to change advisory committee into tripartite governing body from 1st January 2009</td>
<td>Agreed by all three sectors</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td></td>
<td>PAC ensure continued transparency of new information system</td>
<td>Agreed</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td></td>
<td>PAC ensure full consultations on process for creation of executing agency</td>
<td>Agreed</td>
<td>Medium</td>
</tr>
<tr>
<td>Continuous monitoring</td>
<td>MoC commission repeat surveys of buyers sourcing criteria and intentions</td>
<td>Not yet agreed</td>
<td>Medium</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>ILO develop pilot indicators to measure improvements in working conditions, quality and productivity</td>
<td>Agreed</td>
<td>High</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ILO and GMAC monitor factory level gains arising from remediation training</td>
<td>Agreed and underway</td>
<td>High</td>
</tr>
<tr>
<td>Promotion</td>
<td>Marketing the country’s distinctive advantage</td>
<td>PAC agree promotion strategy, including with new Cambodian Investment Board.</td>
<td>Not yet agreed</td>
<td></td>
</tr>
</tbody>
</table>
II. Financing

<table>
<thead>
<tr>
<th>Monitoring and reporting system</th>
<th>Ensuring sustainability</th>
<th>PAC agree a shared financing strategy</th>
<th>Agreed</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ILO initiate discussions on creation of market for remediation, capacity-building services</td>
<td>Agreed and underway</td>
<td>Low</td>
<td></td>
</tr>
</tbody>
</table>

III. Labor market

| MoL review labor law as necessary with technical assistance from the ILO | Agreed | Medium |
| MoL and GMAC consider need for labor adjustment services during the expected shake-up | Not yet agreed | Medium |

Table III.3 – Proposed financing plan for monitoring and reporting

<table>
<thead>
<tr>
<th>Funders</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry +RGC</td>
<td>150,000</td>
<td>150,000</td>
<td>300,000</td>
<td>375,00</td>
<td>450,00</td>
<td>600,000</td>
</tr>
<tr>
<td>USDOL</td>
<td>450,000</td>
<td>450,000</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>WB</td>
<td></td>
<td>300,000</td>
<td>225,000</td>
<td>150,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>600,000</td>
<td>600,000</td>
<td>600,000</td>
<td>600,000</td>
<td>600,000</td>
<td>600,000</td>
</tr>
</tbody>
</table>

Tripartite Governance structure

53. The existing Project Advisory Committee (PAC) has had the mandate to guide the ILO garment sector project. This should be transformed over 2005-2008 into the governing body for a new local organization that will take over full responsibility from the ILO at the start of 2009. The governing body will provide the market with the credibility assurances that ILO presence and project management currently provides. This governing body should still include GMAC, the Ministries of Labor and Commerce, and trade unions. The ILO’s ex-officio presence at the PAC should be replaced by full ILO
participation on the governing body and overseas buyers should be consulted through an annual buyers’ consultative forum. The governing body’s role will be to oversee the monitoring, reporting, remediation and promotional activities, ensuring that they are performed to the highest standards; to hire the Executive Director of the executing agency and to oversee the process of staff hiring. The governing body will establish and directly oversee a system to monitor the quality and credibility of the monitors on an ongoing basis. The governing body should not be involved in day-to-day operational decisions. Rather it should determine policies and procedures.

54. The Ministry of Labor chairs the ILO Project Advisory Committee, but its inspectors do not currently have access to the information system’s outputs, other than through the regular public reports. The Ministry’s inspection staff should be given this access, through the planned computerized database. In this way, the public sector inspectors could be assured that standards are being enforced. Additional consultation and further analysis of the specific areas of the law covered by ILO monitoring versus that of the labor inspectorate may be required. A 2003 report from Cambodia’s Department of Labor Inspection indicates that the number of normal inspections increased 160% between 1999 and 2003, indicating potential for significant efficiency gains if inspections the garment export industry could be reduced, allowing inspectors to focus on the domestic market and other sectors where working conditions are likely worse.

55. While understandably sensitive, there are a number of relevant examples of labor ministries around the world leveraging the labor compliance work of private actors to reduce their own inspection workload. Labor inspectorates in Mexico, South Africa, Kenya, India, and the Philippines at least tacitly recognize the work of non-state monitors as largely substituting for public inspection in certain sectors of the economy (box III.2).

18 This is important for several reasons: the other actors do not have expertise or international experience at a level comparable to the ILO; the composition of the body will change with political and internal shifts in the participating groups, which may have conflicts of interest among themselves, or may deadlock on important decisions. The ILO has experience with working with a variety of stakeholders to facilitate consensus.

19 MOLSAVY, Department of Labour Inspection Report prepared by Mr. Koy Tepdaravuth, Deputy Director and provided to the World Bank FIAS mission in November 2003. The 160% figure was calculated based on extrapolating a 12 month total number of inspections for 2003 based on the reported figure for 9 months. The increase between 1999 and 2002 was 125%.
The Wine Industry Ethical Trading Association (WIETA) of South Africa is a voluntary multi-stakeholder initiative. The objective is to improve the working conditions of employees in the wine industry by means of standard setting, capacity building and monitoring. It was established in 2002.

WIETA has developed a base code on the basis of South African law and the code of the Ethical Trading Initiative in the UK. A corps of independent auditors performs audits on the basis of the code. Suppliers request and pay for the audits themselves; spot audit are being considered. While it is still only tacit cooperation, the South African government recognizes private monitoring as an effective substitute for public enforcement in the wine industry. The ongoing WIETA monitoring in the exporting part of the industry effectively has allowed the public inspectorates to focus their resources on those producing for the domestic market. The Ministry of Labor is represented at the governing body of WIETA, thereby explicitly endorsing the initiative as well as the standards aspired to and the monitoring methodology employed. It is anticipated that buyers will also eventually cease doing their regular individual audits.

An executive committee governs the initiative with representatives of all major constituencies, including producers, unions, NGOs, and the Department of Labour.

E. Final decision steps

56. In the course of the consultations involved in this advisory project, the main thrust of the recommendations in this report and many of the individual recommendations have already been accepted by the Government and relevant stakeholders. The ILO announced its re-branded Better Factories Campaign at the February 2005 Conference “Seizing the Global Opportunity”. Some of Cambodia’s key buyers as well as new buyers have shown strong support for Better Factories Cambodia and have indicated a willingness to coordinate and strengthen the unique monitoring and remediation system.

The Government has agreed to:

- require factories to continue to register with the project for independent monitoring through a prakas;
- participate on the new tripartite governing body;
- continue to pay a share of monitoring costs as part of a funding strategy where the RGC and the Industry will increasingly pick up the costs of monitoring until self-sufficiency.

Unions have agreed to participate on the tripartite governing body.

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20 It was signed by all parties and publicly affirmed. See: [www.betterfactories.org](http://www.betterfactories.org)
GMAC has agreed to:

- participate on the tripartite governing body; continue registration of members in monitoring program and the public reporting;
- continue partially financing the monitoring program if supported by a Prakas.

The World Bank will provide a further 200,000 USD over FY06/07/08 to support the development of appropriate governance and administrative structures.

The following recommendations have not yet been agreed or implemented:

The Ministry of Commerce:

- include subcontractors in the monitoring system;
- clarify the law for the proposed new EPZ, if necessary extending this scheme to factories that will operate there;
- liaise with MOF to solve the problem of VAT acting as a barrier to declaring subcontractors;
- propose assessment of all Ministries’ inspection needs with a view to streamlining;
- commission repeat annual surveys of buyers sourcing criteria and intentions.

The Ministry of Labor:

- examine areas of possible duplication between the ILO’s monitoring role and that of the Ministry of Labor’s inspection services in garment factories;
- accept data from the project’s monitoring;
- review the labor law as necessary with technical advice from the ILO, making it relevant to the changing environment where necessary;
- consider need for labor adjustment services during expected factory-level consolidation.

The ILO project:

- prepare current monitors for transition into the new agency at the end of 2008;
- initiate consultations on the process of transformation into a local executing agency.
CHAPTER IV

IMPLICATIONS FOR OTHER INDUSTRY SECTORS

57. As the final step in this advisory work, the Ministry of Commerce requested FIAS to briefly consider the potential implications of the garment sector’s labor standards focus for other industry sectors. In particular, the Senior Minister for Commerce, HE Cham Prasidh, has consistently argued that Cambodia will not be credible if it claims to care about labor standards in one industry sector, but appears unconcerned about those same standards in other industries. The team therefore considered two issues: first, the potential competitive advantage of labor or environment standards in other key sectors; secondly, the potential instruments at the Government’s disposal to encourage comparable good practice.

58. The tourism industry is the second biggest contributor to GDP and with its recent high profile labor dispute and international press coverage on child prostitution, the hotel and tourism sector seemed to be one where CSR-based initiatives for social and environmental standards might be a promising initial development and risk mitigation strategy. Other sectors where lessons learnt from CSR in the garment industry have potential relevance include agribusiness, forestry, and the oil and gas industry. The assessment and potential instruments at the Government’s disposal in each of these sectors are briefly presented below.

A. CSR in the tourism industry\(^\text{21}\)

59. Revenues from tourism are the primary source of foreign exchange for almost 50 least developed countries. In Cambodia in 2002, international tourism receipts accounted for US$379 million, or nearly 10% of GDP.\(^\text{22}\) It is generally agreed to be one of the most promising growth sectors in Cambodia. Growing at a rate double the world average\(^\text{23}\), Cambodia received just over 1,000,000 visitors in 2004 and most predict a sustained 20-30% growth for the coming years (figure IV.1).

\(^{21}\) A complete version of the report on the tourism industry will be available at http://www.ifc.org/ifcext/economics.nsf/Content/CSR-CountryProjects#Cambodia_0 and provides more specific recommendations for the industry.
\(^{22}\) World Tourism Organization website: www.world-tourism.org
\(^{23}\) World Tourism Organization, 2002 data
1. Tourism growth in Cambodia and its challenges

60. The vast complex of Khmer temples dating from the 9th to the 15th century, found within a 400 square kilometer reserve, recognized as a World Heritage site by UNESCO, gives Cambodia its reputation and prestige as a tourist destination worldwide. Siem Reap, the gateway town and province where ancient Khmer ruins of Angkor Wat are located, has an international airport that receives daily flights from throughout the region. Since the Open Skies Policy was put in place in 1997, the number of direct flights from China, Singapore, Thailand, and Vietnam to Siem Reap has been growing at a fast pace.

61. Phnom Penh, on the other hand, is no longer an important stop for visitors coming to Cambodia. The lack of marketing and promotion from Cambodia has meant that the Angkor temples have been promoted much more actively by tour operators and travel agencies in neighboring countries (e.g. Thailand, Vietnam), who have no incentive to promote Cambodia as a whole.24 As a result, Phnom Penh’s share of the growth has been steadily declining (figure IV.2), as has the average number of guest nights, from 3-4 to just under 2 nights in Cambodia (figure IV.3). Cambodia must emerge from being a one destination country, to make tourism most beneficial to the nation.

24 Wholesalers in Thailand or Vietnam usually must subcontract with local travel agents in Cambodia to bring their visitors to Cambodia thereby lowering profit margins. They therefore seek to limit the number of nights in Cambodia.
62. The lack of planning of this tremendous growth has led to a number of unresolved environmental and labor problems. Infrastructure is limited and concentrated primarily in Siem Reap and Phnom Penh. Energy, water, sewage and waste are all significant problems. Water in Siem Reap is being drawn from 70-80 meters underground by hotels and treated for use, but there have been no geological studies of how much water exists in underground aquifers and one of Angkor’s temples is reportedly falling into a sinkhole, suggesting that the underground aquifers may be rapidly disappearing. Sewage treatment is not required under law for hotel infrastructure at present. Hotels have their own sewage treatment plants, but most guesthouses reportedly dump used water directly into the river, causing noticeable river pollution. Few options for waste recycling are available. Electricity is in high demand, but available in insufficient and unreliable quantity, at very high price. Growth in Siem Reap also has some impact on the workforce, attracting young unskilled workers from surrounding rural areas, and increasing competition for low-skill jobs. At the other end of the job market, the shortage of trained workers is causing major disruption as hotels poach skilled employees from one another.

63. The FIAS advisory project team consulted with most industry stakeholders within Cambodia. The industry was unanimous in assessing that the sector is not boosting the local economy as much as it could through backward linkages. Few Cambodian products and services are available that meet the needs and standards of the industry. 95% of all food produce is imported into Cambodia from Vietnam and Thailand. All businesses consulted agreed that buying more local products and services would be an important contribution to the economic development of communities in Cambodia and at the same time reduce costs.

64. Finally, businesses also mentioned the lack of initiatives targeting visitors’ introduction to Cambodian culture. Traditional performing arts, historic restoration, handicrafts and other local aspects are an important part of the Cambodian culture, but few consider it their role to undertake or support initiatives in this area.

65. There is no Tourism Law in the Kingdom of Cambodia, and no legally enforceable regulations to govern the development of tourism. The Private Sector Working Group on Tourism is playing a key role in working with the government to help develop and review a Tourism Law, a system for Hotel Classification, and the development of a Cambodia Tourism Marketing and Promotions Board (MPB). But these three legal instruments have not yet been approved.

2. Global CSR trends in the tourism sector

66. Globally, some firms have carved out a specific niche in providing tourism services with a focus on environmental conservation, and others have put in place specific practices and programs which are socially or environmentally responsible, but

25 The Private sector working group on Tourism is composed of the Phnom Penh Hotel Association (PPHA), Société Concessionnaire de l’Aéroport (SCA), Restaurant Bar Association (RBOAC), Arts and Crafts Association, and the Cambodian Association of Travel Agents (CATA)
the use of codes of conduct is very limited in the tourism sector. Recently, however, several initiatives have been put in place, including new codes of conduct in international hotel chains and travel agencies, tourism sector indicators by the Global Reporting Initiative, a new Tour Operator Initiative, and country-level initiatives such as Green Deal in Guatemala, Certification for Sustainable Tourism in Costa Rica, and the Certification of Sustainable Tourism Program (Programa de Certificación em Turismo Sustentável) in Brazil.

67. The Tour Operator Initiative states that partners’ performance against sustainability criteria down the supply chain “will need to be monitored and assessed as part of regular reviews of suppliers and improvements can be rewarded by preferentially contracting suppliers that meet the sustainability criteria.” Large hotels have put in place environmental management systems, ethical charters or codes of conduct, whether at the individual hotel level or within international hotel management groups like Accor and Hilton.

68. At the country level, the rationale is that developing such standards helps categorize and certify each tourism company according to the degree to which its operations comply with a model of sustainability. This in turn helps in responding to the changing expectations of the tourists and in meeting investors criteria for tourism projects, thereby enabling the country to compete successfully and differentiate among competitor countries.

3. Conclusions

69. The Kingdom of Cambodia is a signatory to the ASEAN Tourism Agreement which recognizes the strategic importance of the tourism industry in sustainable socio-economic growth, reaffirms adherence to the Global Code of Ethics for Tourism of the World Tourism Organization and encourages all levels of government to carry out programs to ensure the preservation, conservation and promotion of the natural, cultural, and historical heritage of Member States and encourages the adoption of environmental management standards and certification programs for sustainable tourism. The Japanese International Cooperation Agency (JICA) is presently launching the development of an Integrated Master Plan for Sustainable Development of Siem Reap/Angkor Town. However, tourism is growing rapidly, the basic systems for planning and management are not yet in place, and the private sector is not convinced that it is their role to address the gaps.

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27 The Global Reporting Initiative (GRI) is a multi-stakeholder process and independent institution whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines.
28 Excerpts from the Tour Operators Initiative website: [www.tointiative.org](http://www.tointiative.org). The TOI that includes tour operators from a number of countries including Accor and Thomas Cook (France), Atlas voyage and Dynamic (Morocco), First Choice, Discovery Initiatives and Exodus (UK), Premier Tours (USA), Travel Walki’s (Pakistan), and many others, from Switzerland, Finland, Italy, Brazil, etc.
70. Efforts to develop tourism certification programs with international recognition are in their infancy. These initiatives, though anecdotal, confirm the existence of a trend in responsible tourism that could be built on by Cambodia, if the country chooses to brand itself as a comparative haven of responsibility. Costa Rica, for example, has a nationwide certification scheme for its tourism industry since 1997 (box IV.1).

Box IV.1: National Certification for Sustainable Tourism

Costa Rica developed its “Certification for Sustainable Tourism” program in 1997 to categorize and certify each tourism company according to the degree to which its operations comply with a model of sustainability. 4 fundamental aspects are evaluated: physical-biological environment; hotel facilities; customers; socio-economic environment; and translate into a 0-5 rating very similar to the star-hotel classification system. Costa Rica believed developing such a certification system was a condition to survive in the long run as well as helping ensure it was: adapting to the changing expectations of the tourists; responding to investors’ criteria for tourism projects; helping differentiate among competitor countries; and addressing the problem of “greenwashers” in the industry with a nationwide common reliable system.

The Costa Rica Tourism Institute, in charge of the implementation of the program (including verification system), collaborates with a number of other institutions including universities, national accreditation committee, business associations, etc.

71. As Cambodia looks ahead to develop a marketing strategy it could differentiate its offer by developing a niche appeal to the CSR-conscious and higher-end tourists. This would require to shift from the current strategy of seeking to maximize the number of visitors – posing a threat to the environment while providing little returns in terms of amount spent or length of stay – towards one of developing higher-end quality tourism. This would as well reinforce the Royal Government of Cambodia’s strategy to promote the country as environmentally and socially responsible, building on the achievements of the garment sector in improving labor standards. Tour operators are beginning to produce codes of conduct and supply chain guidelines that could help market Cambodia to this growing segment of the tourist market, as well as help the Cambodian industry understand the demands of the socially responsible tourist. The Private Sector Working Group’s current process of drafting “Chart of Tourism” is a step in the right direction.

72. In pursuing such a strategy the Royal Government of Cambodia could:

- develop a national sustainable tourism plan, building on existing efforts for strategic planning in the sector. It may be useful to consider establishing a high-ranking Sustainable Tourism Commission with a nation-wide focus, sanctioned by the King or Prime Minister;

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29 Data show that average tourist expenses vary in direct proportion of the national income of their country. APSARA has suggested exploring the idea of segmenting the high- and low-end market between the dry and rainy season, to smooth tourism flows and expand the tourist seasons. Cambodian travel agents seek to work with the more profitable Japanese market which contracts directly with Cambodian travel agents and is a more profitable market as are the European and American markets.
increasingly involve the private sector in sustainable tourism development, tapping their expertise and interest in enhancing their own reputation as drivers for preservation of the culture, environmental and social sustainability and contribution to poverty reduction. The Government could, for example, support the draft “Tourism Charter”:

- link marketing strategies to corporate social responsibility, in line with the government’s strategy to market Cambodia as a responsible place to do business. This could help appeal to the more CSR-conscious tourists;
- support the institutional development of the hotel associations, including building their capacity and that of the unions to bargain collectively and resolve industrial disputes. This can help stabilize the industry as well as preserve international reputation. An effective, and eventually, unified hotel association could also be a useful platform for launching CSR initiatives in the future, including possibly developing a Cambodian Tourism Code of Conduct for Hotels;
- give priority to tourism actors that have signed up to the Tourism Chart in trade fairs and international promotion activities;
- facilitate obtention of license to operate to actors that have signed up to the tourism chart.

B. The agri-business industry and organic potential

73. Globally, organic produce is a fast growing US$ 27 billion segment of the food industry that has achieved double-digit annual growth for more than a decade. It has seen two primary avenues for expansion: among small farmers – often poor – who either chose to eschew or could not afford Green revolution approaches, and among commercially oriented farmers who perceived new market opportunities in certified organic products.

74. A recent report of the International Fund for Agricultural Development concluded that organics earn more money for nearly everyone involved in its production, processing and trade, while helping resource conservation and soil fertility. The switch to organic farming tends to increase labor costs but has positive consequences in terms of yields and profitability. Labor requirements are generally higher than in conventional systems, so it can help contribute to rural stability, especially where labor is abundant and migration occurs. In addition, developing and managing their own Internal Control Systems, is a way for farmers to both minimize compliance costs and improve their association’s responsibility and management skills and so become better prepared to manage the plethora of other standards that are increasingly mandated for trade.

1. Markets for organic produce

75. Apart from traditional markets, other important markets for organic products are in China, South Korea, Singapore, Hong Kong, and Taiwan. There is a small but growing market for organic food and drink in these countries. Emergent domestic markets e.g. in

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30 International Fund for Agricultural Development, Organic Agriculture and Poverty Reduction in Asia: China and India focus, Thematic Evaluation, January 2005
China, Malaysia, Philippines, Singapore and Thailand are maintaining growth trends. Demand reportedly outstrips supply in China. Domestic price premiums range from 10 percent to 400 percent or more according to market location, quality and products. However, caution should be extended when assessing price premium. While organic premiums are very high in a few markets, the global experience is somewhat less promising as more and larger producers enter this lucrative niche. Established organic commodities like rice, sugar and coffee have already seen considerable reductions in price premiums.

2. National initiatives

76. Organic regulations are already in place in India, Japan, Korea and Taiwan, including official accreditation or approval /registration of certification bodies. Malaysia and Thailand have published voluntary national organic standards (Box IV.2). China, Indonesia, Philippines and Sri Lanka are reportedly finalizing their respective national standards.

<table>
<thead>
<tr>
<th>Box IV.2: National Organic Certification</th>
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<tr>
<td>Organic agriculture is still in its infancy in Thailand not even accounting for 1% of the total agricultural production. It has however shown constant growth and has been developed progressively at the country level.</td>
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<tr>
<td>In 1984 a group of farm leaders, NGOs, environmentalists, and consumers organized “The Alternative Agriculture Network” as a nation-wide forum for developing a more sustainable agriculture in Thailand. In 1998 the Alternative agriculture Network established Organic Agriculture Certification Thailand (ACT) to be the certifying agency for organic agriculture in Thailand. ACT has been accredited by International Federation of Organic Agriculture Movement (IFOAM) in 2001.</td>
</tr>
<tr>
<td>In 1999, department of Export Promotion developed a trade promotion projects known as “Pilot Project on the export of Organic Farm Products” with the main objective of promoting organic production and export of rice, banana, pineapple, asparagus and baby corn. A National Organic Standard Guideline for Crop Production was simultaneously developed.</td>
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<tr>
<td>Thailand area under certified organic agriculture was estimated to be 10 050 ha in 2003. The overall volume of production is estimated to have been approximately 9600 metric tons in 2003 with an estimated total product value of USD 9 million. Almost all products certified are exported to Europe and Japan, only a few are sold locally.</td>
</tr>
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77. Alongside organic agriculture possibilities, an industry wide certification, similar to that of the garment industry, encouraging higher levels of labor and environmental

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32 International Fund for Agricultural Development, *Organic Agriculture and Poverty Reduction in Asia: China and India focus, Thematic Evaluation*, January 2005


34 International Fund for Agricultural Development, *Organic Agriculture and Poverty Reduction in Asia: China and India focus, Thematic Evaluation*, January 2005
standards may as well be put in place as did South Africa in its wine industry in response to buyers concerns (see box III.2) or Kenya with its horticulture industry (box IV.3).

<table>
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<tr>
<th>Box IV.3: Horticulture National Code of Practice</th>
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<tbody>
<tr>
<td>The Kenya Flower Council was set up in 1997 by a group of flower exporters in response to severe media pressure to improve environmental and labor standards in the industry. The objective is to improve conditions while maintaining the industry's international competitiveness. Buyers were involved in the formative phases, but this is an industry-led initiative that only consults with its stakeholders.</td>
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<tr>
<td>The Council has developed a code of practice, with two levels: the silver standard, which is consistent with ILO standards and Kenyan law, and the gold standard which upholds higher environmental standards. Members must submit to audits every six months. They are given a grace period of one to two years to reach compliance with one of the two code levels. Once certified, producers can mark their product with the Council's 'environmentally friendly' logo.</td>
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<tr>
<td>The Council has set up a partnership agreement with one of the earliest and most well-known inspection-based certification programs in the flower industry, the Milieu Programma Sierteelt, set up in 1993 to reduce the environmental impact of the flower industry. Initially this was set up as a Dutch-only initiative, and MPS-certified products succeeded in achieving higher prices in the Dutch market.</td>
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<tr>
<td>The initiative has been successful in terms of membership and volume coverage. The perception of most stakeholders is that environmental and labor standards have improved, but some remain skeptical of the auditing techniques employed.</td>
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78. Apart from setting the standards and putting in place the credible monitoring and certification structures and institutions, the Ministry of Commerce could consider additional incentives to encourage a switch towards organic production. These could include:

- easier awarding of export licenses to those who participate in the certification scheme;
- recognition of the organic certification as equivalent to other environmental or health and safety inspections;
- matching grant offers for companies seeking certification;
- technical assistance to farmers;
- reduced taxes for the transition period to organic certification;
- giving priority to organically certified firms in participation to trade fairs.

C. Logging and sustainable forestry certifications

79. The full scale of the global illegal logging problem is not known, but it is estimated that governments may be losing as much as $5 billion annually in uncollected revenues from forest concessions, and an additional $10 billion from illegal logging practices.

80. Illegal logging not only distorts the markets for wooden products by making legal wood about 10-15% more expensive but also creates a range of problems and challenges by:
contributing to poverty through the reduction in government revenues that could in turn be made available for poverty reduction programs;
- reducing the income that could be available to local communities through legal and improved forest management;
- fostering a vicious cycle of corruption and bad governance;
- widely contributing to deforestation, and consequently to loss of biodiversity, increased risks of forest fires, inundations and mud flows.

81. Cambodia's Forestry Department estimates that only 2.2 million Ha of Cambodia's forests are suitable for commercial logging. Working on the recommended annual cut of 10 m$^3$ per ha over a 30 year cutting cycle, the maximum annual sustainable yield from Cambodia's forests is 733,000 m$^3$, with some forestry experts arguing that 500,000 m$^3$ is the maximum annual sustainable yield. The World Bank/FAO/UNDP Forest Policy Assessment recommended an average minimum royalty of US$75 per m$^3$, giving a potential royalty of US$55 million a year. It states that in recent years, illegal logging generated 1.5 million m$^3$ of timber per year, i.e. over twice the estimated sustainable limit.

1. Forest certification

82. Very similar in the monitoring and reporting system to the apparel industry, forest certification is the process by which forestry operations on the ground are independently assessed against a set of predetermined standards through auditing and monitoring activities. Certification is an excellent tool to prove forest management meets the standards being used (usually going well beyond legal requirements) and can be of use to nations wishing to import only “legal” timber.

83. Forest certification ensures that the forest from which timber is harvested is sustainably managed, and chain of custody certification ensures possibility to track the wood in a product down the whole supply chain up to a specific raw material input (i.e. the log). Both are needed to ensure that a particular product is made of certified wood. As with apparel, certification represents a niche exporting opportunity (box IV.4); it increases transparency in the supply chains and enables to link into the US and EU sensitive markets.
Box IV.4: Why forestry certification?

- To maintain market share and/or differentiate products in a global market place
- 89% of buyers say they want to source responsibly but less than 1% of internationally-traded timber is believed to be certified as coming from well managed forests.
- Indonesian manufacturers have already lost business to other markets because overseas buyers are concerned about the Indonesian timber supply: Homebase, Costco and Carrefour have all taken business valued at US$ 20 millions elsewhere.
- Currently there are moves within several European countries to ensure that governments only procure timber from legal sources.

2. National certification schemes and additional benefits

National certification schemes apply when national standards are developed and are endorsed by the Forest Stewardship Council (FSC) or Pan-European Forest Certification (PEFC) schemes. Bolivia is the first country that has had its national scheme certified. In an attempt to promote responsible forest management more widely, the Bolivian 1996 Forest Law indicates that concessionaries holding an international forest certificate do not need to pass the technical external audit, which is required every five years to get their licenses renewed. The case of Bolivia shows some economic benefits that can be derived from forest certification. Exportations have not only continuously grown in value from US$ 0.18 million to US$ 14 millions from the beginning of national certification scheme, but continued to grow despite the world economic crisis (see figure IV.4). During this same period, exportations of forest products in general decreased from US$ 120 millions to US$ 83 millions.

Figure IV.4 – Bolivian exports of forest products

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35 Survey conducted by PENSA (IFC Program for Eastern Indonesia SME Assistance) at the Singapore International Furniture Fair, report from March 2004, data probably from 2003
37 Datos CFB/SIFOR-BOL
3. Instruments

85. Curbing illegal logging practices can not only help Cambodia protect its forests and preserve its environment but it makes also good business sense. As shown in box 12, buyers reportedly find less sources of certified wood than they would otherwise buy. In addition the FLEG process in the European Union means that exporting to these countries will require demonstration that the sustainable forest management systems are in place.

86. Should the Ministry of Commerce be interested in putting in place an actual ban on illegal logging, it could:

- require all concessions willing to export wood to be FSC (Forest Stewardship Council) or PEFC (Pan-European Forest Certification) certified. Alternatively, the government could decide on developing a national scheme in partnership with either certification schemes and require participation from all concessions;
- make decision to renew the concession permit or license contingent upon certification;
- recognize international certification as equivalent to MoE auditing;
- facilitate funding for concessions embarking into the certification process;
- adapt the scheme for small-scale concessions.

D. Oil and gas industry

87. ChevronTexaco has discovered oil in four exploration wells offshore Cambodia. The drilling program will conclude with one more exploration well that is expected to be completed in February 2005. By the end of the calendar year, it should be clear whether the reserves are sufficient for commercial exploitation.

88. Cambodia lacks legislation covering natural resources extraction and the International Monetary Fund had suggested the country pass laws before beginning to tap reserves. Prior planning and an integrated CSR approach could help ensure that Cambodia does not suffer from some of the ills often linked to the extractive industries.

89. Shared governance systems can help ensure that local concerns are integrated from the start. The Chad-Cameroon Pipeline and Petroleum project, for example, has a nine member government-appointed Provisional Committee, responsible for identifying and selecting local development projects through a participatory process with local communities. It is composed of three parliamentarians from the oil producing region (two are women), two civil society representatives, two government representatives, and two members from the traditional village and district chiefs of the region. Their role is to oversee project execution and evaluate outcomes.

90. According to several sources in both the private sector and the NGO community, there is widespread agreement that there is almost “no external monitoring” in the extractive sector globally, and “no third party audits”; again, this situation offers a potential opportunity to countries wishing to distinguish themselves internationally, with knock-on consequences for other industry sector. One notable example is the monitoring
regime recently established by the Baku-Tbilisi-Ceyhan (“BTC”) oil and gas pipeline project (box IV.5), about to start pumping crude oil from the Caspian Sea to the Mediterranean in 2005, and operated by BP, its largest shareholder.

<table>
<thead>
<tr>
<th>Box IV.5: The Baku-Tbilisi-Ceyhan monitoring system</th>
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</table>
| The $2.9 billion investment project has several layers of monitoring: four internal and five external. The five external monitoring layers are: (1) NGO monitoring; (2) state regulatory monitoring; (3) human rights and security monitoring; (4) social and RAP (Resettlement Action Plan) expert panel; and (5) lender group environmental and social monitoring (e.g., IFC monitoring).

In a groundbreaking monitoring exercise for the extractive industries, BTC Co. also commissioned a hybrid internal/external CSR audit of the pipeline’s construction. Undertaken by independent, third-party, non-BP or BTC employees, the report was prepared for internal purposes only. This recently completed Human Rights Monitoring Assessment measures the legal commitments made by BTC Co. regarding respect for fundamental worker rights and the human rights of members of local communities affected by the project. The Assessment highlights the central legal and reputational risks associated with human rights challenges facing the BTC project, and reflects BTC Co.’s commitment to respecting the highest internationally-recognized human rights standards, including the United Nations’ Universal Declaration of Human Rights (“UDHR”), the Core Conventions of the International Labor Organization (“ILO”), the Guidelines for Multinational Enterprises promulgated by the OECD, the European Convention on Human Rights, and the Voluntary Principles on Security and Human Rights (“Voluntary Principles”).

The Human Rights Monitoring Assessment broke down those international agreements and identified a series of specific rights that BTC Co. had committed to upholding (e.g., the right to non-discrimination and bans on child or forced labor). Monitors then traveled along the course of the pipeline’s right of way in Azerbaijan and Georgia (Turkey is still to be completed) for two weeks, interviewing workers, subcontractors, managers, and affected communities regarding the implementation of those rights.
CHAPTER V

CONCLUSIONS

91. With the end of the quota system, and the significant consolidation now expected, the comparative advantage of the Cambodian garment sector currently lies only in their commitment to labor standards. The Ministry of Commerce has a vision that expands this advantage to other sectors of the economy, seeing the country promoting itself as the organic breadbasket of the region, competing with China on the basis of labor standards. Many of the lessons learnt and the instruments used in the garment sector have potential relevance for other industry sectors.

92. A range of possibilities exist to market the country’s innovative efforts and achievements, expanding the benefits achieved by the garment sector project. The Royal Government of Cambodia should:

- **redirect the garment sector project to inform overseas buyers purchasing decisions**
  The survey of Cambodian garment factories’ key overseas buyers revealed standards to be the only issue on which buyers believe Cambodia outperforms its regional competitors, but very few of the individuals making sourcing decisions appear to have detailed knowledge of the monitoring system or its outputs. This report details the strategy to make the transition from a quota-focused scheme to a market-focused scheme, which provides information to the sectors’ international buyers while dramatically reducing current inefficiencies.

- **while reducing the cost of doing business in the country**
  The buyers surveyed were insistent that compliance with labor standards is necessary for the Cambodian garment industry to survive and grow, but not sufficient. As one buyer put it “What would Cambodia’s prospects look like if they didn’t have an advantage on labor standards? My guess is that the prospects would be fairly dismal”. Seventy-five percent of buyers surveyed concurred, saying that red tape, corruption and high energy costs must also be tackled, if production costs are to be competitive clear that Cambodia.

- **expanding the potential CSR advantage to other sectors**
  As the report’s examples from other countries and sectors illustrate, systems and tools similar to those put in the garment industry could be implemented in other industries.

- **and focusing the marketing strategy of the new Cambodia Investment Board**
The recommendations in this report have implications for the strategy of the new Cambodia Investment Board, which can play an urgently needed role in promoting the country as some kind of safe haven for those buyers and investors who need assurances of appropriate labor and environmental standards. For the existing achievements in the garment sector, data from the computerized information management system can be used to inform an ongoing marketing strategy to buyers and investors, emphasizing continuous improvements in labor standards and the shared commitment of RGC, GMAC and the country’s trade unions.
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