Fashion brands weigh Cambodia strategy after EU curbs trade

H&M, Adidas and others assess cost of suspended duty-free access

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An Adidas logo is pictured inside a shoe. The German company sources 22% of its textiles from Cambodia.

© Reuters PHNOM PENH -- Stripped of some of its European trade privileges, Cambodia is bracing for an economic hit as major brands such as H&M review their production in the country. The European Commission on Wednesday announced it would suspend duty-free access for 40 products from Cambodia, equal to about 20% of the country's exports to the bloc, or some 1.1 billion euros ($1.19 billion). The decision followed the EU's 12-month review of Cambodia's eligibility for its Everything But Arms scheme, which grants developing countries duty-free access for all exports except weapons and ammunition. In moving to reinstate regular tariffs on some clothing, footwear and travel goods, EU officials said Cambodia had violated the human and labor rights provisions of the scheme. They pointed to government oppression of political opponents and independent media as being among "systematic" breaches, giving the commission "no choice" but to adopt the partial sanction. The tariffs -- 12% for clothes and up to 17% for some footwear -- will take effect on Aug. 12 unless the European Parliament and Council object within two months, or four months should an extension be sought. Barring this, economists expect higher export costs will see some textile production shifted away from the country's vital apparel industry. The sector directly employs more than 750,000 workers and generated some $9.5 billion in exports last year -- equal to more than a third of gross domestic product. H&M has indicated it will reconsider sourcing from Cambodia after the country lost some of its EU trade privileges. © Reuters

Already, Swedish giant H&M -- which sources from factories in Cambodia employing about 77,000 workers -- has signaled changes to its supply chain. In a statement, the company said the partial EBA withdrawal would constrain the competitiveness of Cambodia's textile sector. "It will negatively affect future investments, as well as predictability and trust, two crucially important elements of a well-functioning industry," the company wrote. "H&M Group wants to continue to play a part in developing Cambodia in a positive way, including reducing poverty and strengthening human rights. However, due to a lack of adequate initiatives in developing the Cambodian textile industry, and a partial withdrawal of the EBA privileges, we will now further evaluate how the EU's decision will impact our business and production strategy in Cambodia." Stefan Pursche, a spokesperson for Germany's Adidas, which sources 22% of its textiles from Cambodia -- its largest production base for such products -- said the company was reviewing the implications of the EU's decision. Prior to Wednesday's announcement, 20 international clothing companies, including Esprit, Levi Strauss, and VF Corporation, expressed concern about Cambodia's trajectory in a joint letter sent via the American Apparel & Footwear Association.

Discussing the EU's decision, the association's senior vice president of policy Nate Herman said, on top of increased production costs, it would also "hit the country's reputation." "We are strongly concerned with the labor rights situation in the country, and the potential adverse impact the loss of these preferences could have on Cambodia's workers and economy," Herman said. Europe is a crucial market for Cambodia, receiving 45% of its exports in 2018. In the first 11 months of last year, Cambodia's total exports to the EU totaled 5.2 billion euros. Of these, almost 90% were apparel, footwear or travel goods.

A joint statement endorsed by 20 Cambodian business associations, including the European Chamber of Commerce in Cambodia expressed "regret" over the EU's decision. The groups estimated the cost of producing the targeted goods would rise by $140 million, saying government reforms underway could help offset the increase, particularly if combined with government stimulus. "We have full trust in the resilience of the Cambodian people, and are committed to working with those most affected by this decision to mitigate the potential damage to trade and investment, and the Kingdom's reputation," the statement read. "We will continue to work closely with international brands and development partners to strengthen and promote the values of human and labor rights in Cambodia, in accordance with international best practices." The partial sanction comes at an already troubled time for Cambodia's economy, which for years has experienced annual growth of around 7%. The coronavirus outbreak is expected to deal a blow to the country's tourism sector, which is heavily dependent on Chinese visitors and accounts for nearly 20% of GDP.

"Most immediately, this is likely to hit foreign direct investment, and some firms are likely to shift existing production out of the country," he said. "When the tariff changes come into effect, they are set to hit exports hard." Economist Intelligence Unit analyst Fei Xue said Cambodia's increasing exports to the U.S. would help limit the impact of the new tariffs on overall economic growth. The fact that the suspension excluded "more profitable" high added-value garments and footwear products, as well as the fast-growing bicycle manufacturing sector, would also cushion the blow, Xue added. But with labor costs increasing, Xue said garment manufacturers with "thin profit margins" would be "squeezed out" of Cambodia by the higher export costs.

"Minimum monthly wage in the garment and footwear sectors increases to $187 in 2020, approaching the wage levels in Vietnam and far higher than those in Bangladesh," Xue said. "We expect more fiscal and policy support from the government to improve business conditions and retain foreign investments in the affected sectors." Government officials have flagged reforms that lower production costs, including reduced electricity prices and streamlined export procedures. Beijing, Cambodia's biggest donor, has also vowed support to help Cambodia deal with the fallout. But with Cambodia often criticized for investment barriers such as poor infrastructure, the loss of some trade preferences will weaken its appeal over rivals vying for low-cost manufacturing.

Hiroshi Suzuki, chief economist at the Business Research Institute for Cambodia, said countries such as Bangladesh, Sri Lanka and Vietnam -- the latter of which has just signed a free trade agreement with the EU -- were "very strong competitors." Suzuki said the EBA suspension and a slowdown in China had long been pointed to as major risks for Cambodia's economy. "Now, both of the major risks have become obvious," he said. "The slowdown of the Cambodian economy this year will be inevitable."

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