An Economic History of Cambodia in the Twentieth Century

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The research for this economic history of Cambodia was completed, for the most part, by mid-2004. This was a convenient cut-off point as it marked one hundred years since the death of King Norodom I, the event which had signalled French determination to implement and enforce the terms and conditions of the two conventions already signed with the monarch rendering Cambodia a protectorate of the French colonial empire. More significantly, by 2004, Cambodia seemed to have effectively “turned the corner” from its status as a post-conflict society to one where some observers were beginning to speak in terms of its genuine transformation, both political and economic, into a stable, modern democratic state firmly aligned with other globalised neoliberal market-oriented economies. In fact, the Cambodian economy boomed after what was widely regarded as the final step in Prime Minister Hun Sen’s consolidation of power over the ruling Cambodian People’s Party and thus the state apparatus when, at the end of 2003, he aggressively and definitively asserted his authority over the conservative left faction within the party.¹

The boom years from the beginning of 2004 to the final quarter of 2008 appeared to justify the efficacy of neoclassical/neoliberal economic theory and strategies as applied via the intervention of international financial institutions (IFIs) to developing countries like Cambodia whose economies had been seriously affected by decades of internal strife. Between 2005 and 2007 inclusive, Cambodia’s real GDP growth averaged around 11 per cent; in 2005, it achieved 13.3 per cent, a growth rate second only to that of China.² Despite warnings by non-government commentators that the growth was narrowly based on the textiles and clothing industry, tourism, and the construction sector, all of which
were particularly vulnerable to exogenous shocks, and that the profits of development had been unevenly distributed so that rural poverty had hardly eased over the preceding decade, all the key economic indicators pointed to further robust growth.

With the wisdom of hindsight, regular citizens and economic policy makers and planners alike may discern the early tremors and warning signs of the sudden bust of global financial markets that occurred in the final quarter of 2008. While in developed western countries there had been some concern over the ever-escalating level of personal debt, spurred on by easy access to cheap loans, and the concurrent boom in real estate property prices, in Cambodia, too, the rush to speculate in land, fluctuations in the price of gold which reached an absolute high of one thousand dollars an ounce in May, along with rising food prices and unusually high inflation that peaked at 26 per cent around mid-year had further exacerbated the widening gulf between the few very rich and the many poor. By the end of the first quarter of 2009, the ramifications of the credit crisis for the so-called “real” economy were being felt around the world. Leading economic specialists were unwilling to predict how deep or how long the recession would persist, or how well, or even if, the institutions so familiar to the neoliberal marketplace would weather the storm.

While the Cambodian economy experienced several shocks after rehabilitation commenced in 1993, it had yet to experience a recession serious enough to assess the ideological foundations on which that rehabilitation was built. Throughout the 1990s, Cambodia had been a political and economic laboratory for testing ideas about political transition and economic development: from a command to laissez-faire capitalist economy, from large to small bureaucracy, from domestic to export-oriented production, and so on. Cambodia’s compliance with the demands of the IFIs to adjust the structures of its national administration in accordance with small but “good” governance stipulations so that market forces could operate with maximum freedom had to be supported and guaranteed by generous grants and soft loans from those same IFIs. Thanks to these buffers, the Cambodian economy was largely sheltered from the Asian financial crisis of 1997–98; the sharp downturn in the economy that year had more to do with repercussions from the July 1997 coup than with the regional financial collapse. The high degree of dollarisation also protected the national currency from the worst effects of that crisis as it played out in other regional countries, while preferential treatment awarded to its garment exports was an incentive for foreign investors to maintain their enterprises in Cambodia. In 2008, however, the situation
was markedly different. The 2008 financial crisis originated in the U.S.A.,
the chief market for the garments and footwear manufactured in the
foreign-owned factories located in and around Phnom Penh that are
worked by Cambodian labour. Consequently, as the economic situation
in America worsened, so did the economic outlook for Cambodia and its
dollar dependent riel, causing many observers to question the soundness
of the structural changes that the economy had undergone over the
previous 15 years.

The Global Financial Stability Report that was released by the
International Monetary Fund (IMF) in April 2009 stated baldly that “the
withdrawal of foreign investors and banks together with the collapse in
export markets create funding pressures in emerging market economies
that require urgent attention.” The report warned that as recessions tend
to be deeper and longer lasting when associated with a financial crisis
not only would net private capital flows to emerging markets be negative
in 2009 but also that “inflows are not likely to return to their pre-crisis
levels in the future.” The general advice from the IMF was for govern-
ments to initiate fiscal stimulus packages and to improve financial regu-
lation and supervision.

Just one month prior to the release of that major report, an IMF
mission visited Phnom Penh to review what it termed “recent economic
and financial developments.” It noted that construction activity and
foreign investment were slowing rapidly, that garment exports were under
serious pressure, and that the tourist arrival growth rate had reversed.
Ominously, while agriculture had performed better than anticipated the
previous year, the mission predicted that the fall in global agricultural
prices would have an impact on farmer incomes in 2009. The only
positive note in the mission’s statement was that inflation would probably
fall back to single digits, in line with lower oil and food prices and
weakening consumer demand. The mission estimated that real GDP
would fall by 0.5 per cent, although it admitted that the drop might,
in fact, be worse and that the outlook for the years 2010 and 2011 was
“uncertain.” Its recommendation to the Cambodian government was to
allow the deficit to rise to 4.75 per cent of GDP with spending focused
on “pro-poor social outlays and safety nets and high-quality infrastructure
projects that would strengthen competitiveness.” It further urged the
government to continue strengthening its tax administration efforts in
order not to erode its already low revenue base.

Although estimates vary according to sources, real GDP growth for
Cambodia is projected to be 6.5 per cent in 2008 and 4.75 per cent in
2009, which is certainly disappointing compared with average growth
of 11 per cent over the previous five years, but still better than that of some other countries at a comparable level of development. Nevertheless, Cambodians, particularly young people aged between 15 and 24 who make up almost one-quarter of the total population, can expect to experience unemployment, dislocation and increasing anxiety as the economic catastrophe unfolds. As mentioned previously, Cambodia needs to maintain a minimum of 6 per cent growth in order to provide opportunities for job seekers leaving school. Given the economy's job dependence on garment exports and foreign direct investment for sustained growth in the construction sector, and the major contraction in both those sectors, it is obvious that jobs will be very difficult to find and that young job-seekers will be faced with difficult choices.

The garment and textile industry in Cambodia is particularly vulnerable. Almost all of the capital involved in the industry is foreign-owned; Taiwan owns one-quarter of all the factories and Hong Kong, China and South Korea, together, account for around one-half. As jobs are lost in home countries, the allocation for jobs elsewhere will inevitably shrink. In an effort to sustain production, the Cambodian government has responded by suspending its tax on factory expenditures, but this is surely a self-defeating measure that will ultimately affect general revenue.

As well as the garment factories, the construction industry has generated jobs for thousands of young rural workers, thereby supplementing the incomes of their families and easing the burden of rural poverty. As an almost immediate response to the financial crisis, however, more than 30 per cent of construction jobs either evaporated or were scaled back. To date, about three-quarters of the construction sector has been funded by foreign investors; for the rest, the Cambodia Institute of Development Study notes, a regulation of the National Bank of Cambodia limiting bank lending to the property sector to 15 per cent of the bank's total loan portfolio has made it difficult for local developers to access finance to complete projects. As a combined result, property prices plummeted by around 25 per cent in the last half of 2008 and more construction projects were cancelled or scaled back.

The tourist industry is notoriously susceptible to sudden global economic downturns, to rumours of health epidemics and even to the whims of fashion. Tourism, however, was one of the pillars on which Cambodia built its post-1993 economy. In 2008, 2.1 million international tourists visited Cambodia, earning the sector around US$1.62 billion. The unprecedented growth in tourism drove the rapid rise in property prices and the construction boom in and around the main sites and venues located in Siem Reap, Phnom Penh, and Sihanoukville. The small and
medium enterprises that cater to the construction and tourist industries, such as building materials outlets, transport companies, tourist agencies, tuk tuk drivers and motodaps, will be adversely affected by the turn-around in economic activity, although they will undoubtedly prove to be more resilient than the big investors. Family-owned and operated small businesses still typify the national economy; traditionally, they rely on their own capital or have only minimal borrowings from banks or other money-lenders.

Similarly, while the agriculture sector generally may suffer from a drop in commodity prices as a result of global recession, it seems likely that food crop producers will be the last and least affected by the crisis. Like the small and medium retail, processing and industrial enterprises, the crops sector has benefited very little from foreign investment. In fact, from some perspectives, Cambodia's quest for foreign direct investment has had chiefly deleterious effects on the farming economy. The most disturbing impact of the recent boom in property prices has been on family-scale agriculture. Throughout the country, but most particularly in those areas close to the city and to major tourist venues, farmers have been squeezed out by property development. In some cases, agricultural land has been confiscated by powerful political parties backed by military force. During the timber boom, farmers lost access to forests and other natural resources, while common land was increasingly incorporated into private holdings. All of this, along with population pressure on land and the division of family property into ever-smaller plots, has kept rural poverty levels virtually unchanged even through those periods when GDP growth rates were registered in double-digit figures.

There is no social security net for unemployed, dispossessed Cambodians. Moreover, there are few charitable institutions or other mass organisations that can provide relief for them. Therefore, when the full force of the global recession hits the Cambodian economy, those most affected by it, namely the retrenched garment workers and the short-hire, minimally skilled construction workers, along with job-seeking school leavers, and the underemployed in the shrinking tourist industry will turn either to the informal sector in the towns to sustain their livelihood or they will return to the village and the family farm, if it still exists or if its capacity will still support them. Others will seek paid employment abroad, if possible, as emigrant workers and more may follow them as they find it too difficult to readjust to life in the countryside.

These, then, are the most urgent challenges for the immediate future: to create job opportunities, especially for youth; to maintain current
standards of health and education services; and to ensure political stability and security. It is inconceivable that the Cambodian economy will revert either to the command type of the period 1975 to 1989 or to a pre-capitalist, semi-subsistence type that persisted before the revolution. At the same time, however, the gains made since 1993 must be maintained. As every other crisis in Cambodia’s modern history has demonstrated, it has been the resilience of the traditional rice farmer that has brought the economy back from the brink of total collapse. Undoubtedly, this will again be the case, but the Cambodian rice farmer who dominates at least 90 per cent of the agriculture sector, deserves some assistance to fulfil this task.

At the 2008 international donors’ meeting held in Phnom Penh in December, almost twice the regular annual sum of assistance was pledged, or US$951 million. It is expected that this added bonus will be used as a stimulus package and invested in national infrastructure projects. Should a large percentage of this package be spent on irrigation infrastructure, improved distribution and marketing facilities, and credit facilitation for local rice milling operations, Cambodian agriculture might finally achieve its long-term goal of modernisation.

Cambodia will survive the current global financial crisis. In the longer term, however, the national economy will have to respond and adapt to greater and more intractable challenges. Climate change will necessitate genuine commitment to fulfilling national policies on natural resources management. During the 1990s, Cambodia squandered its precious forests with little benefit to the treasury and with serious consequences for the environment and the economy. When climate change affects the delicate balance of ice and melt that regulates the tides of the Mekong, and when population pressure and resultant consumer demand for power and irrigation upstream interfere with natural flow through water capture and harvest, how will Cambodia, with its economy still largely based on agriculture and agro-processing, fare?

To a large extent, the answer depends on the sort of relations that Cambodia can forge with the other countries in the sub-Mekong basin and especially with China. Incorporation into the family of Southeast Asian nations was heralded with joy and relief when Cambodia became the tenth member of ASEAN, and despite occasional rifts with Thailand ostensibly over ownership of Preah Vihear temple and the ever-present suspicion of Vietnam’s intentions along the border, ASEAN membership will continue to be an important plank in Cambodia’s ongoing economic development. The economic effects of the growing influence of China in the region, however, will be of greater concern throughout the century. Since
2005, China and South Korea have emerged as the dominant investors in the Cambodian economy. In that year, together, they accounted for 74.2 per cent of all foreign direct investment, with South Korea as the main investor; in 2008, by the time of the crash in November, China had surpassed all others, providing 61.7 per cent of FDI to Cambodia, with South Korea in second place with 34.7 per cent. Thus, together, they accounted for 96.4 per cent of all foreign investment; none of the other investors reached even one per cent. This is hardly an ideal situation for a small, aid-dependent nation with low levels of domestic savings and capital. As further proof of South Korea’s increasingly dominant role in Cambodia’s economic development, an agreement with the Korea Exchange was announced in September 2007 to open a Cambodian stock market by the end of 2010. The Securities and Exchange Commission of Cambodia was launched in April 2009 to establish disclosure and capitalisation guidelines for companies planning to list on the proposed stock exchange.

Protecting national security and ensuring Cambodia’s political stability will, naturally, be essential for further economic growth. Given the political turbulence of the twentieth century, and the critical challenges of this century, no one can be sure what will happen when the present generation of leaders exits the scene, or when the CPP loses its ascendency, but it is certain that both the likelihood and the degree of political turmoil resulting from such changes will be determined by the nature and the state of the economy. Economics, as Francis Fukuyama reminds us, “is grounded in social life and cannot be understood separately from the larger question of how modern societies organize themselves. It is the arena in which modern recognition struggles play themselves out.”

Few would argue with Cambodian economist, Ear Sophal’s assertion that politics in Cambodia is predicated on power and money: the more wealth a leader possesses, the more status is accorded him and, by corollary, the more power one has, the greater are the opportunities for accruing wealth. He also underscores the paradox that Cambodia has grown rapidly in recent years despite lacklustre governance, noting that the country appears to be slipping even further down the Corruption Perception Index, ranking 162 out of 179 countries in 2007, and that tax revenues remain at abysmal levels, “on par with Niger, Tanzania, and Togo.” For him, the tax collection system, characterised as it is by informal payments or “bribe taxes” that are off budget, serves only to weaken state capacity and to strengthen the culture of patronage. It demonstrates, he says, that “authorities do not need a modern rational bureaucracy, just loyalty in the chain of hierarchy.”
The persistent and all-pervasive patronage system is indeed irrational. How is it possible, then, to argue that economic transformation, engineered according to ultra-rationalist neoclassical economic theory, has taken place? Caroline Hughes and Un Kheang point to several positive outcomes of Prime Minister Hun Sen’s consolidation of power in 2003, adding that Cambodia’s political institutions are now significantly better developed and more predictable than they were ten years ago. They use the term “economic transformation” guardedly, to describe the current context only, noting that it represents “a visible change in the level and nature of economic activities from the 1990s to the 2000s.” Nevertheless, they are confident that the global financial crisis will cause only a slowdown in the transformation process, not a reversal of the transformations wrought over the past five years:

... Peace and stability seem better assured and the government is pursuing an altered course, which is focused less on exploiting the illegality made possible by state weakness and more on guaranteeing market returns, not only to military and political elites, but also to investors from across the region and the world.

It must be reiterated that no one argues that a return to past practices is likely; on the other hand, not all analysts are comfortable with the generous sweep of the term “transformation.” At the peak of Cambodia’s boom, in late 2005 when GDP growth rates were at an all-time high, respected economist Sok Hach lamented that “[t]he structure and embedded political tradition has limited economic growth coupled with high economic aid stalling necessary internal economic competition.” Furthermore, he doubted the authenticity of the political reforms, noting that the country was democratising “not from a desire for genuine reform, but in response to the imperatives of aid dependency.” The civil administration reform, he argued, had only created a more complex system with more over-lapping committees but “the fundamental and systemic cause of administrative dysfunctions relates to the maintained patronage system that Cambodia does not seem to be able to relinquish.” He proposed that the patronage system stifled competition in the private sector, because smaller businesses were at an unfair disadvantage due to the concentration of enterprises owned and controlled by just a few people with close ties to the leadership. Consequently, the owners of small and medium enterprises have no influence on economic policymaking, and instead, face ongoing problems that can hardly be resolved by weak legal institutions.
While, for the most part, Sok Hach’s arguments are convincing, his assumption that the Cambodian private sector has “a massive potential” to contribute to sustainable growth and poverty reduction provided that the patronage system releases its grip on economic policy-making may be over-stated. The garment industry, for instance, foreign-owned and largely unaffected by the patronage system, has not proved to be a catalyst for further light manufacturing or any other economic activity beyond an increase in the number of small retail outlets for seconds and discards from the factory floor. Given the basic preconditions of peace, political stability and an encouraging global economic environment, the private sector, in general, will no doubt continue to grow and to contribute further to economic development, but the scale of enterprises within the sector will remain as small or as large as individual families can manage. This is the traditional habit of small and medium enterprise in Cambodia. The same holds true for agricultural activity. There is little scope for the development of modern, large-scale corporations on the scale of, say, Sony or Hyundai, on which national economic growth could be based.

For an historian, it is intriguing to illustrate the parallels of the current situation with Cambodia’s other short-lived “Golden Age” of stability and prosperity that existed between 1956 and 1961. In her seminal paper on the economy of the Sangkum Reastr Niyum (SRN), Laura Summers posited that “in matters of economy, … status considerations rather than market conditions or impersonal economic needs, were paramount in government policy making and economic practices.”

In other words, throughout that period when Sihanouk believed he was engineering economic transformation, in fact, in the view of the ruling elite, “the flow of goods, services and money inside the country was most properly subordinated to and submerged within the patterns of deference, consumption and largess in Khmer society.” As in the boom years of 2004–8, the prosperity of the early years of the SRN was aid dependent. When Sihanouk terminated the flow of American aid in 1963, it was not the rich but rather the poor peasants who suffered the consequences. Their gradual exclusion from the rural status order, Laura Summers suggests, contributed to the emergence of a “class situation” by the late 1960s, while “exclusiveness in industrial employment practices and slow expansion in industry promoted a deep sense of grievance among the young.” No one would suggest that Cambodia is likely to undergo another abortive attempt at social revolution, but the similarities with the not-so-distant past are a cause for reflection on the peculiarities of Cambodian culture that give rise to crises of this sort.
Therefore, in general, I accept the assessment that during the five years from 2004 to 2008, the Cambodian economy grew in a way that suggested the changes deliberately made to institutions and infrastructure in the preceding decade were positive and long-lasting, and that these changes represented “transformation” insofar as the situation was more stable and more predictable than it had been throughout the 1990s. It is undeniable, however, that this development came about despite lacklustre governance and actually increasing levels of official corruption. Official corruption is symptomatic of the persistent and all-pervasive patronage system that not only hinders the establishment of a rational bureaucracy but also acts as a brake on genuine economic competitiveness and therefore on the potential for growth of the private sector. Furthermore, as modern Cambodian history shows, an economic crisis, such as the one precipitated by the termination of U.S. aid in November 1963 or the current one, is insufficient motivation to change old habits of governance, however irrational they are or how disastrous the consequences of intransigence might be.

The persistence of the patronage system is, of course, intricately tied to the web of social relations, habits and mores that constitute Cambodian culture, and since economic life is embedded in social life, it cannot be divorced from culture. Francis Fukuyama advises that one of the most important lessons we can learn from an examination of economic life is that a nation’s well-being, as well as its ability to compete, is conditioned by a single, pervasive cultural characteristic: the level of trust inherent in the society. He warns that modern institutions are a necessary but insufficient condition for national prosperity; they must be combined with certain social and ethical habits if they are to work properly:

Societies that have very strong families but relatively weak bonds of trust among people unrelated to one another will tend to be dominated by small, family-owned and managed businesses. On the other hand, countries that have vigorous private nonprofit organizations … are also likely to develop strong private economic institutions that go beyond the family.

This description, as Fukuyama intended, most readily applies to overseas Chinese societies and, as elsewhere in the Southeast Asian region, Chinese families also dominate the small and medium enterprise sector in Cambodian economic life. These Chinese family businesses sometimes have extended networks throughout the region, with trust forged by family or clan bonds. Although Khmer participation in commercial activity has increased markedly since 1990, Khmer entrepreneurs typically
owe their success not to family ties, which tend to be weak beyond the nuclear unit, but rather to political patronage. The patronage system, in effect, forges trust in a low-trust society, a cultural characteristic of Cambodia that surely pre-dated the Pol Pot regime. It effectively marries power and wealth and distributes the benefits of both in ever-diminishing returns down the hierarchy, the *khsae* or strings that tie the beneficiaries to their individual patron. The demands of reciprocity are real and understood. It goes without saying, therefore, that the rise and fall of entrepreneurs has less to do with commercial skill and diligence than with political favours. In such conditions, it is difficult to accept that genuine transformation has occurred in the Cambodian economy.

The antidote to all this, as Fukuyama and the long line of specialists in moral economy back to Adam Smith prescribe, is a rich and complex civil society. It is still far too early to predict whether the multitude of non-government organisations that emerged in Cambodia throughout the 1990s will fulfil this Herculean task, but a beginning has been made.