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The Cambodian Wild West



By ABHEEK BHATTACHARYA, May, 10 2012

Tiny Cambodia might seem like the most exciting place for business in Asia these days. Regulations are minimal and often non-existent. Income taxes are left simple. Returns on capital won't get debased by the government, since the reigning currency is the U.S. dollar. Judging by sheer growth—Phnom Penh hit double digits often last decade—these sound like the right ingredients for a successful frontier market.

There are a lot of frontier men here trying to succeed too, including foreigners. Leopard Capital CEO Douglas Clayton, one such foreigner who runs a \$34 million private-equity fund in Cambodia, reckons one of the reasons for the country's success is that "it treats local and foreign investors the same." Foreigners can own 100% of just about anything, which makes Cambodia "one of the only free economies in emerging Asia," he says.

But on closer look, Cambodia isn't free. It's a free-for-all, where without proper rules, only the most well-connected thrive. The country may be prospering now, but over time, it will prove to be a reminder that even fast-developing societies can't do without one key ingredient: political reform that helps enforce the rule of law.

That reminder may come sooner than later. Last month, the government inaugurated a shiny new stock market amid much fanfare, as a way to attract more foreign capital. It hoped to capitalize on past growth and prove the country is modernizing, yet after the opening days' euphoria, the market slumped.

Despite the potential for expansion, the broader economy engenders little trust. The government officially launched its stock exchange last July, but ran into one key difficulty: It couldn't find enough companies with clean books that can survive public scrutiny on listing. Nine months later, only one stock went on offer, a state-owned water utility which may not even need the capital.

Cambodia's problem is hardly a shortage of start-up capital; rather it's that buyers and sellers have little faith in transactions. Phnom Penh ranks 164th among 182 nations in Transparency International's latest index of corruption perceptions, the worst in Asia after Burma and North Korea. This already dissuades American multinationals from setting up factories, notes

Hiroshi Uematsu, managing director of the Phnom Penh Special Economic Zone.

That's not a convincing record for new foreign investors to now part with their cash for a minority stake in public companies, as the government wishes. If the stock market gains a reputation as a crooked casino—and many observers worry it could—even locals will stay away.

Perhaps that will finally persuade officials to pay less attention to glitzy stock listings and more to the mundane task of nation building. The country was engulfed in civil war barely 20 years ago which, along with the Khmer Rouge before it, eviscerated its institutions. On the plus side, this chapter in history accidentally created conditions for today's laissez-faire economy, since the state now has poor capacity to implement regulations or collect direct taxes. But the flip side is that Cambodia resembles a Wild West, where the sheriff in town is unaccountable and the norm of the land is cronyism.

Indeed, Prime Minister Hun Sen is worsening the state of affairs. Cambodians may credit him on the economic front, because he formalized the flexible regulations history informally bequeathed to him. But politically, he has been in some form of power since 1979, consolidated it in a 1997 coup, and has kept concentrating it in the executive thereafter. Three opposition legislators resigned last year in frustration at the way the government intimidates them, calling the National Assembly a "rubber-stamp parliament."

As for the courts, a United Nations report in 2010 concluded that "the executive dominates" them, starving this branch of resources and freedom. That squarely hits property rights, since without the judiciary to defend them, titleholders can see their land illegally usurped.

Land grabs and illegal logging are fast becoming the biggest problem in the countryside. Unrest over this flared recently, and after a military policeman last month killed a prominent activist who was investigating some of these illegal activities, Mr. Hun Sen temporarily suspended land grants to domestic and foreign companies.

Even within the executive, Mr. Hun Sen's tendency is to focus power in his office. The bureaucratic machinery doesn't get a chance to mature, and it's little surprise that citizens can get away without paying taxes.

These factors are at the heart of corruption. Legendary levels of tax evasion force officials to turn to other sources to supplement their meager incomes, while weak checks and balances let them get away with it.

Small and micro businesses, often not registered, survive by allegedly paying bribes. BHP Billiton, the world's largest miner, recently found itself in the crosshairs of antigraft activists who alleged that the Anglo-Australian firm paid \$2.5 million in bribes for a bauxite mine in 2006. Both BHP and Mr. Hun Sen deny the charge, saying the money went to a social fund to build schools, hospitals and a dam.

In this environment, most multinationals are willing to work in Cambodia only if they can operate on a parallel track, where some rule of law is assured. Recent big-ticket investors have flocked to SEZs like the one Mr. Uematsu runs, because they offer simpler procedures. "Companies have fewer headaches" here, he says, because otherwise their "dealings with

local authorities [wouldn't be] clear enough." Local courts aren't trusted to follow due process, so investors settle disputes through arbitration in Singapore.

That's no recipe for long-term growth, the lesson being that political institutions like the bureaucracy and courts matter. Cambodia might be exceptional in the extent that it lacks institutions, but in the government's current intent, there's a whiff of the same attitude prevalent in other Asian capitals. Mr. Hun Sen wants to be likened to the strongmen of Asia who have lifted their nations into modernity, yet his own example shows why strongmen who focus on economics without bothering about creating accountable political systems might leave a poor legacy for their countries.