

# Cambodia's Transition to Sustainable Development: Preconditions, Recommendations, Obstacles

**Ralph M. WROBEL**

**Westsaxon University of Applied Science, Zwickau, Germany**

**Abstract:** Cambodia suffered dramatically from the Khmer Rouge regime in 1975 to 1979 as well as from Vietnam's invasion and the following civil war till 1989. Both caused enormous destruction, not only of infrastructure, educational institutions, the financial and health system, but – even more importantly – to its human capital. After 1989 Cambodia's economic transformation started but is insufficient until now. The conception of a market order – introduced by Walter Eucken (1952/90) - may be a helpful approach to improve the economic and social situation in the country. But before constitutive or regulative principles of a market order can be implemented in Cambodia successfully some basic political problems must be solved. They are defined already by North / Wallis / Weingast (2009) as rule of law for the elite, civil society, and consolidated control of the military. Additionally, there are further obstacles which must be drawn into consideration like cultural differences etc. It is the aim of this paper to describe the political and economic situation in Cambodia briefly. Then the necessary preconditions for sustainable development in the country will be introduced. Subsequently an economic policy in line with the market order conception will be recommended and further obstacles will be discussed, at least.

*Keywords: Cambodia, transition, sustainable development, social market economy*  
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## 1. Introduction

After independence from the colonial powers in the 20<sup>th</sup> century a lot of less developed countries (LDCs) in Africa, Asia and Latin-America oriented their institutional framework to

socialism and communism. (Besters / Boesch 1966: 1537-1545) Also development aid was centrally organized and state dominated for decades. A fundamental change took place in 1987 with the Brundtland report “Our Common Future” which focused primarily on sustainability in connection with development of LDCs and environmental problems. The new conception concentrated predominantly on the domestic institutional framework of the LDCs as well as on the international framework. Both should be changed to improve the conditions for governmental development policy and initiative of the poor themselves. Additionally, the idea of the necessity of a long-term policy establishing a free basic order, which is characterized by human rights, rule of law, democratization, good governance, and efficient market institutions, evolved. (Clapham undated) But also nowadays, economists like Jeffrey Sachs or Paul Collier argue that free market will not work for the development of the “bottom billion” in the poorest countries of the world. Instead, they offer technocratic, administrative solutions to the poor (e.g. Sachs, 2005; Collier 2007). In the author’s opinion this solution is wrong. Reality shows that the richest societies in the world are market economies. As a special kind of regulated capitalism the author recommends the approved conception of Social Market Economy as basis for a sustainable development. The idea of Social Market Economy is based on the principles of economic order by the German economist Walter Eucken and was introduced in West Germany after WW II by Minister of Economic Affairs Ludwig Erhard. While the world was talking about an “economic miracle” we can state that the positive economic development in West Germany was in large part the result of this special economic approach.

Cambodia suffered dramatically from the Khmer Rouge regime in 1975 to 1979 as well as from Vietnam’s invasion and the following civil war till 1989. After that Cambodia’s economic transformation started but is insufficient until now. Therefore, the conception of a market order by Walter Eucken (1952/90) as theoretical basis of a Social Market Economy may be a helpful approach to improve the economic and social situation in the country. In the country’s political elite a dialogue on Social Market Economy has already started. For instance, in 2009, leaders of the ruling Cambodian People’s Party and others Asian Centrists adopted an “Angkor Initiative for Stability, Peace and Prosperity: A Centrist Model for Asia”. As main component the initiative includes “*Social Market Economy as middle path between unfettered, free market capitalism and state-controlled socialism.*” (Angkor Initiative 2009) Since then, the Konrad Adenauer

Foundation, a German political think tank, organised a lot of additional discussions on this topic with political deciders as well as economists and students.

But before any market order can be implemented in Cambodia successfully some basic political problems must be solved. They are defined already by North / Wallis / Weingast (2009) as rule of law for the elite, civil society, and consolidated control of the military. Additionally, there are further obstacles which must be drawn into consideration like cultural differences etc. It is the aim of this paper to describe the political and economic situation in Cambodia briefly. Then the necessary preconditions for sustainable development in the country will be introduced. Subsequently an economic policy in line with the market order conception will be recommended and further obstacles will be discussed, at least.

## **2. Social Market Economy as Development Model**

Market economies are able to attain a higher GDP per capita by functioning market incentives and freedom of entrepreneurs and consumers. In contrast to a laissez faire system a Social Market Economy is combining private enterprise with measures of the state to establish fair competition, low inflation, and social welfare. Therefore, the basic theoretical approach of Walter Eucken (1952/90) includes a regulatory framework of a functioning price system, monetary and fiscal stability, freedom of contract and private property, open markets but also the principle of liability and the principle of constancy of economic policy. In contrast to a free market approach the Social Market Economy takes also weaknesses and problems of the market system into consideration. Thereby, "prosperity for all", a more equal distribution of income and wealth can be attained. As result, the constitutive principles are accompanied by so-called regulative principles like the necessity of a strict competition policy, interventions into the labour market, internalising of external effects and a few social measures as well as the provision of public goods. (Wrobel 2011: 48-54) The main policy instruments are not interventions into market processes but a consequent implementation of the principles. Last but not least, the Social Market Economy combines personal freedom with democracy and the rule of law. Eucken (1952/90: 304-308) postulates an interdependency of each economic order with the neighbouring social, juridical and political order. As he mentions, all orders within a society effect each other.

Therefore, on the one hand a strong state accepting the principles of solidarity and subsidiarity is necessary precondition for a Social Market Economy. Only if rules and laws can be enforced by the state, the regulative framework of a Social Market Economy can work well. Supervision of economic actors and penalising violations of rules ensure that rules are adhered and incentives benefits society. On the other hand, the conception of a Social Market Economy consists of institutions which allow a country to develop in a sustainable way.

How such a role model can be established in different countries or societies worldwide? First, it must be stated that not the concrete German model of Social Market Economy is supposed to be implemented anywhere. Only the abstract principles of the market order in terms of Walter Eucken shall be guidelines for institutional development. Each society accepting these guidelines has to choose its own characteristics of the principles. Therefore, the conception of Social Market Economy is not a static program which should be copied within a one-to-one imitation process. In contrary, it is a collection of abstract principles which must be adapted to the regional, national and cultural circumstances. As result, real characteristics of Social Market Economies may be very different.

While implementation problems in Western societies are not to be expected as important, in less developed countries of the Southern hemisphere cultural as well as political constraints can be estimated as more or less problematic. Already North/Wallis/Weingast (2009) focus political restraints by distinguishing so-called limited access orders and open access orders. While the first are growing slowly and are vulnerable to shocks the latter enjoy a mainly positive political and economic development. Limited access orders, also called natural states, are characterised by polities without consent of the governed, a relatively small number of organisations and the predominance of social relationship organised along personal lines, including privileges and social hierarchies. As North/Wallis/Weingast (2009: 12) pointed out most of the societies in the world are such limited access orders. In contrast open access orders characterised by a bigger, but more decentralised government, a rich civil society with lots of organisations and widespread impersonal social relationships including rule of law, secure property rights, fairness and equality. Therefore, all countries trying to implement something like a Social Market Economy have to become an open access order, first. Concrete, North/Wallis/Weingast (2009: 150-166) define two steps for natural states to become an open access order. First, personal relations within the dominant coalition have to be transformed into

impersonal ones. Then, three doorstep conditions have to be fulfilled. These conditions are first of all the implementation of the rule of law for the elites. Second condition is the existence of continuously lived forms of public and private elite organisations. That means a civil society with lots of organisations which has to be implemented. And third, the military must be come under consolidated political control, for instance the Ministry of Defence. But this process will only occur if the members of the dominant coalition find it advantageous to transform their privileges into general, impersonal rights.

Last but not least, it must be emphasised that economic institutions that fit in one country may not be the right ones in other societies. The specific culture of a society seems to play an important role. It must be recognised that people, characterised by cultural differences with respect to the values and norms, influence the performance of institutions. As North (1990: 3-12) pointed out, rules, norms and strategies which shape individual and organisational behaviour can be identified as institutions, while beside formalised rules also habits and other informal rules of society must be taken into account. Formal institutions like laws and regulations can be designed by politicians and enforced by the state administration. In contrast, informal Institutions like social conventions, ethical and religious convictions (“culture”) are evolving during time and are not enforceable by a state administration. Both may be contradictory. Thus, it is obvious that cultural patterns influence the success of development processes. A successful transfer of a market order implies that special foreign formal institutions grow together with given informal domestic ones. Otherwise, the imported formal institutions will be rejected sooner or later. The success of such an institutional import depends on the right selection of imported rules, their adaptation to domestic conditions, and their familiarisation in the host society.

### **3. Implementation of Social Market Economy in Cambodia**

#### ***3.1 Political and Economic Situation in Cambodia***

The Khmer Rouge regime in 1975 to 1979 as well as Vietnam's invasion and the following civil war till 1989 caused enormous destructions in Cambodia, not only of infrastructure, educational institutions, the financial and health system, but – even more importantly – to its human capital. (Cuyvers et al. 2009: 245) Especially during the Khmer Rouge

rule market and business activities were completely abolished. No money or trade existed. Private ownership of all kind was banned. After the signing of the Paris Peace Accord in 1991 the United Nations Transitional Authority (UNTAC) organised first democratic general elections. Three major parties, the National United Front for an Independent, Neutral, Peaceful and Cooperative Cambodia (FUNCINPEC), the Cambodian People's Party (CPP, the former communist party backed by the Vietnamese troops) and the Buddhist Liberal Democratic Party, formed the first government. Nevertheless this political compromise led to an uneasy arrangement of two co-prime ministers. Political tensions emerged within the coalition in the election years 1997 and led to factional fighting between armed forces in Phnom Penh. (Guo 2006: 26-27) While after the elections a new coalition was formed, the CPP is dominating the country's policy until now.

Cambodia's economic transformation started already in 1989 after the Vietnamese troops left the country. The new regime was seeking external assistance from the West after the former Soviet Union collapsed. Urgently, it permitted limited private ownership of property and private enterprises. The country was opened up to international trade etc. However, the private sector developed slowly. (Guo 2006: 27) Only since the first elections in 1993 Cambodia has engaged in the liberalisation of its economy. Additionally, the country adopted an extremely open policy towards foreign investments and international trade.

Between 1994 and 2004 light industries like the garment and textile sector as well as hotels and restaurants developed most successfully, basing on attracted FDIs. In the garment and textile sector this success can be traced back to the most favoured nation status that was granted to Cambodia by the U.S. and the European Union. Therefore, investors came from other Asian economies to take advantage of the country's quota free access to developed-country markets. Thanks to Cambodia's cultural heritage like the Angkor temples and increasing political stability, the country became a much-favoured destination for international tourists, too. (Cuyvers et al. 2009: 245-254) Nowadays, Cambodia's main export commodities are clothing and footwear as well as timber, rice, fish, and tobacco. In 2011, main export partners were the U.S. (39.5%), Canada (8.2%), Germany (7.8%), Vietnam (6.0%) and Japan (4.3%). In contrast, Cambodia imports oil, cigarettes, gold, construction materials, machinery, motor vehicles and pharmaceutical products from its neighbouring countries mainly in Southeast Asia. The economic structure of the Cambodian economy is that of a less developed country characterised by a large agricultural subsistence economy. While in 2011 about 55.8% of the labour force was employed

in the primary sector, only 16.9% worked in industry and 27.3% in the service sector. (CIA World Factbook 2013) Additionally, Cambodia is quite dollarised: the U.S. dollar serves all the three functions of money, as medium of exchange, as store of wealth and unit of account. (Menon 2008: 228-230)

Prior to the financial and economic crisis, Cambodia enjoyed a decade of high growth and relative stability. Real GDP growth averaged over 9 percent during 2000 to 2007. This is the highest of any low-income country in Asia. Consumer price inflation has fallen sharply from an average of 56% (1990-1998) to an average of 3.5% (1998-2007). Additionally, the International Monetary Fund (2011: 3) states: *“As result of the global crisis output collapsed, exposing longstanding structural vulnerabilities. Preliminary estimates suggest that growth fell some 10 percentage points below its pre-crisis average in 2009. Cambodia was hit harder than comparator countries by the global recession, given vulnerabilities that are in part a legacy of a generation lost by civil strife.”* Anyway, real growth rate is estimated 6.6% in 2012 but consumer price inflation low 2.9%. Nevertheless, Cambodia's GDP per capita is USD 2,400 (2012 est.), only. (CIA World Factbook 2013) As already the World Bank (2006: 3) has reported poverty in Cambodia has fallen by 10 – 15% over the period from 1994 to 2004. However despite of this positive development Cambodia remains as one of the poorest countries in the region. Additionally, income growth and poverty reduction are unevenly distributed. While urban areas are characterised by relatively large gains in the standard of living, progress in rural Cambodia is quite modest. This can be traced back to the underdeveloped agriculture as well as to poorly defined land rights. (Engvall et al. 2008: 74-75)

At all, analysing the macroeconomic data Cambodia has been quite successful in its transformation strategy. Compared to its neighbours in Indochina it is the only true market economy of capitalism. All others, Vietnam, Laos and also China remained as hybrid economic systems combining state and market somehow. Therefore, most analysts agree that Cambodia is on the right way with its agricultural policy, poverty reduction programs and gender equality politics. (Weggel 2007: 79) But as Guo (2006: 69) points out, until now also the Cambodian system is characterised by a combination of *“remaining patterns of communist principles of organisation with traditional hierarchies of power, elite politics, power struggle among three dominant political parties and within the dominant party CPP, and their strategic interactions”*. Indeed, while the industrial sector is growing fast Cambodia is dominated by subsistence

agriculture. (Swann 2009: 57) Corruption, an insufficient educational system, political and economic uncertainty as well as weak legal and institutional structures are the main reasons. Therefore the Cambodian economy was one of the less competitive ones worldwide for years. (Weggel 2007: 76) Fortunately, the country's competitiveness is on the rise. This can be stated by the development of the country's rank in the Global Competitiveness Index which rose from 109 in 2010/11 to an 85 in 2012/13 (of 141 countries). (Schwab 2013: 126) A new orientation of economic policy, concrete an orientation at the principles of a Social Market Economy, maybe the right decision to support the country's further development.

### ***3.2 Steps to a Social Market Economy***

#### ***3.2.1 Accomplishment of Political Preconditions***

Before constitutive or regulative principles of a market order can be implemented successfully and will be able to improve the economic situation in Cambodia some basic political problems must be solved. Political uncertainty in 1997 and 2003 concerning elections, fighting of armed forces in the capital Phom Penh showed clearly that Cambodia is far away from being an open access order in terms of North/Wallis/Weingast (2009). Therefore, an introduction of basic principles of a Social Market Economy must start with the consequent achievement of all three doorstep conditions as they have been set by these authors.

First of all, the rule of law must be implemented for the Cambodian elites. While in Cambodia the former communist party-state apparatus has remained politically dominant. (Guo 2006: 78) Rule of law can only be enforced by the establishment of functioning juridical system as well as by successful anti-corruption measures. Here, Cambodia is on the right way. Since 1993 the Cambodian governments have been very active to complete the legal framework to international standards. For instance, a Civil Code as well as an Anti-Corruption Law has been approved. As the Cambodian prime minister, Hun Sen (2009: 11) states, the government and the judiciary are investing heavily to increase the capacity to implement the enforced legal framework in a fair, transparent and predictable way. But in the short run results are still poor. At the moment Cambodia holds rank 157 in the World Corruption Perceptions Index. (Transparency International 2012) Therefore, the fight against corruption must be intensified much more.

Additionally, a civil society with lots of organisations must be promoted to establish an open access order in Cambodia. But also in this field Cambodia is only at the beginning of a long road. As the Cambodian Human Rights and Development Association (2010) states: “*Year 2009 has been marked by an increase in restrictions on the freedom of expression, especially against politicians and representatives of civil society organisations critical of the Cambodian Government.*” Further on, this organisation wrote in its report that freedom of assembly - exercised through non-violent protests - has been strongly restricted, too. Also government declarations on the draft NGO Law have created considerable alarm among both international as well as national NGOs. In this way, the development of a civil society is restricted and interfered by the ruling elite.

Also, the military, police and other authorities must be come under consolidated political control. But the political parties CCP as well as FUNCINPEC maintain not only their own media and bureaucratic entities but also bodyguard units. The CPP retains an additional monopoly over the courts, the local authorities and the security apparatus. Because each party pursued strategies to strengthen its own power basis, the conflict and tension between the parties have shaped reform policy and the process of transformation. (Guo 2006: 69) But elections in 2008 were considered as fair and not violent although the CCP was able to attend approx. 60% of the votes. (Inter Press Service 2008) Therefore, progress in peaceful development can be stated.

All these three requirements are basic preconditions for the further development of the Cambodian society. But at the moment, a highly personal-oriented and elitist political and economic administration will hardly be able to introduce the institutions of a Social Market Economy within a short period. Therefore, the success of such a strategy is depending on the long-term willingness of political entrepreneurs to implement the preconditions as well as the principles of such a market system. On the one hand, the constant dominance of the CPP in the government since the local elections in 2002 has begun to enjoy more room to push through reforms. Therefore, the CPP elite's ability to push economic as well as political reforms this will be most important for the whole Cambodian society. On the other hand, incentives for institutional change are small in a monopolised situation.

Maybe, globalization and in concrete institutional competition will help to change the situation in a middle term. As Mummert and Mummert (1999: 171-173) emphasise institutional competition does not work in less developed countries like in developed ones. The mechanism of

exit and voice does not lead automatically to the development of rule of law and other basic institutions of an open access order. As main reasons they identify market failures in the institutional sphere (e.g. a prisoner dilemma of political actors). Fortunately, the case of Cambodia is a little bit different than in other less developed countries. By the UNTAC a quite well working democratic system was established which allows the voice mechanism to work partly. Exit (or no-entry) is possible especially for foreign direct investors and tourists who became more and more important for the Cambodian economy. For instance, due to the political tensions between CPP and FUNCINPEC which resulted in armed conflicts reduced FDI inflows and scared away potential investors. Simultaneously, in 1997 and 2003 a decline of visitors in Cambodia could be measured. (Cuyvers et al. 2009: 247-254) Consequently, the ruling elite may see the necessity of institutional development because the advantages will be higher than economic stagnation and a following loss of power in the next elections. Additionally, the ruling CPP is divided in competing fractions. (Guo 2006: 70) The implementation of a Social Market Economy and its institutional preconditions may be a rewarding political strategy for one of them.

### *3.2.2 Introduction of a Market Order - Constitutive Principles*

Simultaneously to improvements according to the preconditions of an open access order further formal institutions must be implemented in Cambodia. Comparing the real situation in this country with the principles of the market order makes obvious a lot of institutional lacks. Following the structure of constitutive and regulative principles a lot of remarks have to be done on the Cambodian market system. Already the first and fundamental principle of a market order, the flexible prices, is not successfully implemented in Cambodia. On the one hand, prices on commodity markets are formally decontrolled, direct subsidies are eliminated, and the state only purchases rice at considerably higher prices. On the other hand, factor markets do not work sufficiently. While the labour market is quite free, there exists only a weak land market because of a lack in property rights. The capital market is insufficient, too. For instance, there exists still no really working stock market in Cambodia. Indeed, a stock exchange in Phnom Penh was opened in 2011 but only three state companies, Phnom Penh Water Supply Authority (PPWSA), Telecom Cambodia and Sihanoukville Autonomous Port, were preparing listings at that time. In

2013, only PPWSA was listed and traded at the Cambodian Securities Exchange. (CSX undated) Additionally, Cambodian companies are not listed on other national markets. Therefore, an extremely limited access to domestic capital reduces investment chances. Also lending is limited by the low confidence in the juridical system as well as a lack of credit information, as investment managers in Cambodia say. (Marks 2010) Indeed, a central bank and two-tier banking system was introduced in 1993. The Cambodian Central Bank has to oversight on commercial bank regulation, to print money and to control foreign exchange. However the banking system is quite underdeveloped. Additionally, there existed a wide mistrust into the system among Cambodians in the last decade. (Guo 2006: 149-150) Fortunately, this seems to have be changed. As a poll in 2013 resulted 87% of Cambodians trust their banking system. Of course, such a survey outcome is questionable in a country that still has only 13% penetration of banking services across the population. (Thust 2013) Hence, banks still cannot fully perform their role as financial intermediaries. Therefore, not only the banking system but also the capital market must be developed and stabilised as soon as possible.

Nevertheless monetary and fiscal stability seems to be achieved in Cambodia as the country's low inflation rates respective deficit rates show impressively. After a rise of deficits in 2009, the 2010 budget target of a gradual fiscal consolidation was on track again. (International Monetary Fund 2011: 7) The main reason for this stability seems to be the high dollarisation of the Cambodian society. Measured as the ratio of foreign currency deposits to broad money, dollarisation has risen steadily from about 60 percent in the late 1990s to about 80 percent in 2010. (International Monetary Fund 2011: 14) Therefore, the scope of the Cambodian central bank to pursue monetary policy is very limited. It is only administrating the managed floating exchange rate of the Cambodian currency, the Riel. Dollarisation is the direct result of the disastrous economic situation after the destruction of financial institutions in the 1970s and the communist management in the 1980s combined with the large USD inflow during the UNTAC administration in the early 1990s. (Menon 2008: 228-232) On the one hand, the costs for the Cambodian economy are high. Kang (2005) estimated the cumulative loss in seigniorage to be USD 682 million for 2004, with an additional annual loss of USD 61 million. On the other hand, Cambodia benefits from greater price stability and reduced exchange rate volatility. Therefore, dollarisation in Cambodia can be understood as foreign anchor of macroeconomic stability. From a Social Market Economy perspective this stabilisation is of high interest for all economies but

first of all for emerging and transforming countries. Therefore, the dollarisation in Cambodia should not be badmouthed while for solutions should be searched. In the long term – for instance - a Currency Board may replace the uncomfortable current regime.

Private property rights are fundamental for each type of market economy. At first glance, privatisation in Cambodia was successful. Already in 2001 the private sector share of GDP amounted for 76.3%. But it must be drawn into consideration that private enterprises were rural family farms. Thus, at all Cambodia is lagging behind the neighbours in privatisation. Actually, Cambodia's most vital resources and sectors like transportation, electric power, mining, fishery, forestry, beer and alcoholic beverages remain under state control. (Guo 2006: 148) However one of the most pressing issues in the transformation process is resolving dispute concerning access and tenure to land, forest and fishery resources. Major obstacles to the private sector development are the lack of clear legal framework and weak institutional capability to enforce the existing laws. In Cambodia reform of the former communist system began with agricultural liberalisation. Already in 1989, collectivisation was formally abandoned. Today peasant family economies have developed into a dominant form of production. Unfortunately, peasant families have only access to land through some kind of constitutionally guaranteed long-term tenure. As result, in 2006 only 10% of rural households in Cambodia had full legal rights to their agricultural land. (Guo 2006: 89) While the Cambodian government has encouraged FDI in agriculture and the agro-industry, cumulative FDI into this sector is only on a low level for years. This is probably partly due to land tenure and administrative barriers. (Cuyvers et al. 2009: 254) Only Chinese investments into rubber plantations are considerable but discussed controversial in present Cambodia. Additionally, it must be emphasised again that poverty is predominantly a rural phenomenon in Cambodia. With a large population engaged in agriculture, it is obvious that access to land is a crucial determinant of welfare. Many rural households suffer not only from landlessness or a lack of formal property rights to the land they live on but from deprivation. But where rural households are deprived of their land increased poverty can be expected. Therefore, the weak protection for land ownership is one of the acutest problems in Cambodia. (Engvall et al. 2008: 79-80) Last protests of farmers could be recognised in 2013 showing how the government is neglecting the problem. (Titthara 2013) A solution of this problem can only bring a basic reform of landownership in Cambodia. A system characterised by restitution of land to owners from the pre-communist period may be the fairest one but also bureaucratic and time

taking. Therefore, a combination of such a system and a new allocation of land lots to the peasants may be the better way.

As is well known from the theory of Social Market Economy private property can only take positive effects on the development of society if sufficient liability rules limit economic actions to responsible ones. In contrast, no liable behaviour of economic actors can be expected if they are not owners of the resources they use. In this way, weak land ownership titles and long-term tenure without legal protection will induce waste and destruction of natural resources. Especially foreign direct investors in the agricultural sector get incentives to exploit the tenured land in contrast to invest into sustainable development. Additionally, the defective juridical system characterised by unjust decisions by courts and corruption does not support responsible behaviour of economic actors. Thus, it is not surprisingly that authors like Menon (2006:231) state that in Cambodia a financial contract enforceability is absent. Therefore, corruption is seen as the most problematic factor for doing business in Cambodia until now. (Schwab 2013: 126) Without solving these basic problems a sustainable development can never be achieved.

In contrast, like macroeconomic stability also the opening of the country is a success story. Cambodia has recently started to implement a liberal trade regime. Private sector foreign trade was permitted. Licensing requirements for most of goods were removed. The import tariff system was streamlined and export restrictions reduced. (Guo 2006: 150) Cambodia became member of ASEAN in 1999 and is therefore further reducing tariffs in line with its obligations under the ASEAN Free Trade Agreement. A WTO membership could be achieved in 2004. (Menon 2006: 231) To foreign investors the country opened up already in the mid of the 1990s. The Law on Investment was enacted already in 1994 and included a lot of incentives for investors. Beside a low corporate tax rate of 9% an exemption from this tax for up to eight years, a permission to carry forward losses for up to five years, a tax-free import of capital goods, intermediate goods and construction materials etc. was decided. These benefits are available to approved projects introduced by Cambodian investors as well as by foreigners, too. In 2003 the law was revised, corporate income tax exalted to 20% and tax holidays were shortened. Although relatively large amounts of FDIs have been attracted long delays in investment approvals because of the country's bureaucratic slowness are hampering the development. (Cuyvers et al. 2008: 4-5) In 2013, two special economic zones quite closed to the Thai border are set to discussion. (Kirnsay / Renzenbrink 2013) This will improve the openness of the country for sure.

The application of other constitutive principles can be discussed briefly. Common economic freedoms like opening of national markets and freedom to contract are not really implemented in Cambodia. But compared to other Southeast Asian countries economic freedom is at an average level. Indeed, with respect to the Heritage Foundation Index of Economic Freedom Cambodia is ranked “mostly unfree” with 56.6 score points. However Burma (36.7) and Vietnam (49.8) are ranked even as “repressive”, while China (51.0), Laos (51.1) and Indonesia (55.5) share the Cambodian category but ranked with a lower score. In contrast, emerging countries like Thailand (64.1), Malaysia (64.8), and South Korea (69.6) are ranked as “moderately free” and industrialised countries like Japan (72.9) as “mostly free”. (Heritage Foundation 2010) Therefore, Cambodia has a lot to do with respect to further liberalisation. Also consistency in economic policy must be improved. Not only the above mentioned political uncertainty in 1997 and 2003 concerning elections but also a frequently changing legislation and problems of enforcement create unsecure circumstances for investments and consumption decisions. Therefore not only the Cambodian tax system is “*relatively new and (...) characterised by numerous taxes and frequently changing legislation, which is often unclear, contradictory, and subject to interpretation*” (DFDL Mekong 2008:1) Even because in a transformation country institutional changes belong to the country’s specific situation a clear political goal and orientation of all measures to this goal are of great importance. Here, an orientation to the principles of a Social Market Economy can help to stabilise the transformation process in Cambodia, too.

### *3.2.3 Introduction of a Market Order - Regulative Principles*

In contrast to the free market approach the idea of the Social Market Economy accepts the necessity of state interventions especially in the fields of public goods, anti-trust policy, redistribution policy and correction of different market failures. Due to the specific situation in less developed countries like Cambodia public goods like elementary school education and public infrastructure development are of greatest importance, too. Only if a country can offer a functioning infrastructure and skilled workers to potential foreign direct investors it is competitive in the international competition for FDIs. A main problem of the necessary investments in these fields is the long-term profit. Therefore, it must be the most important goal

of the Cambodian government to improve the situation in both fields. However about 20% of the Cambodian children do not go to the elementary school. (Weggel 2007: 82) Poverty reduction programs will be not successful without a sustainable creation of education chances for the rural population in Cambodia. Education, focussing on basic literacy and numeration is an essential ingredient to the ability of the people to make use of income-generating opportunities beside agriculture. For now, access to and lower cost of primary education is a concern, but over time also higher levels of education should be main goal of educational policy in Cambodia. (Engvall et al. 2008: 93) Due to infrastructure, it must be stated that the Cambodian road network is in bad condition (especially in the rainy season). Only one to some extent working harbour in Sihanoukville is another bottleneck of further economic development in Cambodia. (Weggel 2007: 81) Fortunately, Cambodia opened its air space for direct flights to Siem Reap closed to the Angkor Park. In this way, a simple inflow of tourists to the cultural heritage of Cambodia is ensured. A quite well working bus system complements this infrastructure for tourists which have to be improved further on.

In contrast, the necessity of a competition or anti-trust law in a less developed country like Cambodia is not so obvious. Maybe it is *“like a fish needs a bicycle”* as some commentators call it because in their opinion developing countries may be better off without adopting and implementing a rigorous competition law regime. (Hammer 2004: 3) Twenty years ago, this opinion may have been right also for Cambodia. But the situation changed dramatically. The entry of multinational enterprises to Cambodia since the mid of 1990s brought both positive and negative impacts on the country. On the one hand, more competition brought about by FDI activities induced domestic firms to become more efficient and provided spillovers in skills, management techniques or technical knowledge. On the other hand, the presence of foreign firms drove indigenous firms out of business because of too strong competition or unfair practices. (Cuyvers et al. 2009: 260) Therefore, the urgent preparation and introduction of a competition law as well as an independent competition authority is necessary in Cambodia from a Social Market Economy perspective. Of course, competition law will not play the main role within the process of poverty reduction in the short term. Nevertheless, it will hamper the establishment of economic power groups by FDIs. Thereby it will limit the exploitation of consumers as well as of suppliers of production factors (like labour and land) also nowadays. On the other hand, it must

be recognised that a competition law will make an impact only if the preconditions for an open access order are at least nearly fulfilled.

As has already been mentioned above, inequality in Cambodia is on the rise. The distribution of FDI – and as result of jobs – is very uneven in the country. The capital Phnom Penh has been by far the most successful in persuading foreign investors and drew about 77% of total inward FDI measured in fixed assets as well as in employment. The city of Sihanoukville with its port and beaches comes in second position with only about 8% of total FDI measured by fixed assets. As result, the rural poverty rate is about four times as high as in the capital of Phnom Penh. (Cuyvers et al. 2009: 256) That brings rural poverty to the frontline of economic policy, because the widening gap between rich and poor causes destabilisation as result of increased migration, social pressure and rising criminality. However any kind of intervening redistribution policy would not be the right answer because it is not financial feasible. Also the establishment of an extensive social security system – financed by insurance contributions – is not possible in Cambodia at the moment. As the theory of Social Market Economy emphasises implementation of constitutive principles of the market order must have priority. In this case the fair definition of property rights on land and thereby the cutback of landlessness seems to be more successful. Also redistribution by the Cambodian tax system is not implemented in reality. While the Cambodian Law on Taxes provides for a 20% tax on profit rates realised by a legal person, taxes on salaries depend on an incremental scale, with the highest marginal rate of 20%. These taxes are accompanied by withholding taxes, a value added tax of 10%. (DFDL Mekong 2008: 3 – 9) From a Social Market Economy perspective this tax system seems to be in line with a careful redistribution of income and wealth in the Cambodian society. But as for instance DFDL Mekong (2008: 22) points out, relatively easy avoidance of tax registration requirements result in high non-compliance by all those that do not need to have a corporate legal entity. Therefore tax avoidance reduces the redistributive effects of the tax system massively. An illegal redistribution of wealth by corruption has to be expected, too. Therefore, a simplified and more transparent structure of the Cambodian tax system would be more successful in dividing the financial burdens of state activity.

While regional and personal redistribution policy is quite underdeveloped countrywide labour market interventions are restricted only to the clothing industry which developed during the 1990s. Following a rapid expansion local unions were becoming more active. Because

industrial action was increasing international labour rights groups were drawing attention to working conditions in Cambodia's garment factories. (Adler et al. 2009: 5) Therefore, in the clothing industry a relatively high minimum wage for workers exists. Additionally, it is widely and strictly enforced because of small number of large factories, because surprisingly inspections are more easily to be made by the International Labour Organisation in Cambodia. (Yamagata 2009: 101) Also the Free Trade Union of Workers of the Kingdom of Cambodia (FTUWKC) was founded in 1996 containing of about 60,000 members in the clothing industry. (ICTUR et al. 2005) This can be seen as success, but workers' rights are not enforceable because of weak juridical system. Furthermore, the labour market interventions are restricted to this sector. But this is not surprisingly because beside the tourist sector garment is the only industry in Cambodia. Thus, an extension of labour market interventions will go hand in hand with the further development of different industrial sectors in the country. Last but not least, negative externalities like environmental pollution, exploitation of natural resources like forests or agricultural land have to be corrected. Whether the Law on Environmental Protection and Natural Resource Management (1996) will be enforced in a country like Cambodia is questionable. As has been discussed above clear property rights are more promising than protection laws which are not enforceable.

### ***3.3 Further Obstacles***

Also when preconditions of an open access order would be fulfilled and constitutive as well as regulative principles of a market order would be introduced formally further obstacles on the way to a functioning Social Market Economy are to be expected in Cambodia. On the one hand, the Cambodian culture is characterised by informal institutions like old traditions of trade and commerce, entrepreneurial activities in history and experiences with a civil society from the pre-civil war period. Already the ancient Angkor Empire was characterised by trade and commerce. Markets are an "old practice" in Cambodia, as local scientists attest. But on the other hand, communist traditions like collectivisation, a lack of experiences with freedom and entrepreneurial initiative, informal networks (like the Chinese *guanxi*), corruption and the existence of widespread subsistence economy are overlapping these advantageous informal institutions. These experiences led to a deep mistrust of Cambodian people into state institutions,

the government and the banking system. (Guo 2006: 25-28) Additionally, Cambodia is clearly not a “Western Society” but an Asian one. Therefore, fundamental different kinds of traditional beliefs and behaviour have to be expected.

As result, the adaptation and learning process related to the transformation must be enforced in the Cambodian society. Helpful will be the import of knowledge like management abilities, technical knowhow etc. by foreign direct investors. Also, foreign support by NGO activities has to be mentioned. However the main burden must be taken by the Cambodian politicians. They have to act as political entrepreneurs, offering the conception of Social Market Economy to their voters as the “Cambodian Way of Market Economy”. Thereby, it is quite unimportant if they call this system a Social Market Economy or not. But they have to adapt the formal institutions, basing on the principles of a market order, to the national Cambodian circumstances. This will be an evolutionary process characterised by trial and error. Additionally, they have to make the people familiar with these institutions so much that informal and formal institutions are growing together to a unique but consistent economic system.

As the experience from Germany after the World War II and from the transformation state in Central and Eastern Europe show this is a time-taking process. But what does that mean for Cambodia? In Germany, it took about ten years (1948-1958) to introduce the constitutive as well as regulative principles of a Social Market Economy. But preconditions were fulfilled mostly and the cultural adaptation process was quite simple, too. Nowadays, 20 years after the fall of the Berlin wall transformation processes in the most Central European states like Poland, Hungary or the Czech Republic the can be declared as completed successfully. However in less developed countries like Cambodia a much longer period of learning and adaptation must be expected. This should not lead to apathy. The advantages of the Social Market Economy are so great that a time-taking process of fulfilling preconditions, adaptation and implementation of constitutive as well as regulative principles, and the backing by political entrepreneurship will be profitable in the long run.

#### 4. Conclusion

As the analysis above shows a market order has a lot of advantages, also for less developed countries. These advantages became more obvious after the financial and economic crisis again. While American neo-liberals like Milton Friedman saw the answers to the failed Keynesianism in a total withdrawal of the state from the economy, German ordo-liberals tried to create a new connection between a strong state and free market economy. Hence the conception of Social Market Economy is signed by its regulatory framework and the freedom of the players to act without restrictions within that frame. Thereby, the approach of a market order is not only interesting for developed market economies as alternative but also for transforming and emerging societies searching for a new target of institutional development after the crisis of free markets nowadays. But it is hard to implement a market order because of cultural, political and other restraints. However this should not lead to the conviction that a Social Market Economy cannot be implemented in developing countries. Restraints can be removed within a learning process over time. But on the other side, one should not be too enthusiastic like advocates of a free market approach have been after the fall of communism promising a large growth payoff to free market reforms. (Easterly 2008: 13-15) Such a process will take time. Disappointments in the short-run are possible, too.

Cambodia has to start with the fulfilment of the preconditions for an open access order in terms of North/Wallis/Weingast (2009). The political elite must introduce the rule of law in the country as soon as possible. Here, a rigorous struggle against corruption and the improvement of the juridical system have to be emphasised. A civil society with lots of organisations must be promoted, not hampered by the ruling elite. Internal as well as external political conflicts must be solved peacefully. The state's monopoly of military and police power must be carried through. This requires the willingness of the current Cambodian elite.

Simultaneously, but to be understood as second step, the Cambodian government has to introduce formal institutions as they are represented by the constitutive principles of a market order. Focus should be on the establishment of a capital market (stock market, banking system) and the improvement of real estate markets. The privatisation of state enterprises must be enforced and property rights in real estate must be defined. Especially, a fair definition of property rights for agricultural land will improve the social situation in Cambodia reducing

poverty in the rural regions. According to the regulative principles of the market order the country's government has to focus on the supply of long-term important public goods, first of all basic education and also the improvement of infrastructure. Issues like anti-trust policy, the implementation of a competition law and independent competition authority should be taken in consideration, too. However it is clear that such formal institutions will not work correctly if the preconditions of an open access order are not fulfilled at a minimum level.

At all, a fast economic miracle in Cambodia by the introduction of a market order cannot be expected. The country is still a limited access order, a lot of formal institutions must be implemented, and not all implemented formal institutions are already enforced. Additionally, there exists a necessity of learning effects. Also short-run disappointments (like in the global crisis) must be expected. The demographic imbalance in Cambodia, characterised by a larger growth of population than of jobs in industry and services may be obstacles of development in the future. But the basic conception of the Social Market Economy offers a new and for the whole Cambodian society profitable goal of a sustainable transformation.

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**TRANSFORMACJA KAMBODŻY W KIERUNKU ZRÓWNOWAŻONEGO ROZWOJU:  
WARUNKI WSTĘPNE, REKOMENDACJE, PRZESZKODY**

***Streszczenie:***

Kambodża dramatycznie ucierpiała wskutek reżimu Czerwonych Khmerów w latach 1975-1979, a także podczas inwazji wietnamskiej i nastącej po niej wojnie domowej do 1989 roku. Obydwa te epizody w historii kraju doprowadziły do ogromnych zniszczeń, nie tylko w zakresie infrastruktury, instytucji edukacyjnych, systemu finansowego i zdrowotnego, ale – nawet w większym stopniu – w sferze kapitału ludzkiego. Począwszy od 1989 roku Kambodża znajduje się w fazie transformacji, której skutki są jednak niewystarczające. Koncepcja systemu rynkowego, rozwinięta przez Waltera Euckena (1952/90), może być użytecznym podejściem do poprawy sytuacji społeczno-ekonomicznej tego państwa. Jednak zanim z powodzeniem wdrożone zostaną w Kambodży ustawodawcze i regulacyjne zasady systemu rynkowego, należy rozwiązać pewne podstawowe problemy polityczne. Zostały one zdefiniowane przez Northa / Wallisa / Weingasta (2009) jako zasady prawa dla elit, społeczeństwo obywatelskie oraz skonsolidowana kontrola sił zbrojnych. Co więcej, istnieją kolejne przeszkody, które należy wziąć pod uwagę, jak choćby różnice kulturowe itp. Celem artykułu jest skrótowne omówienie politycznej oraz gospodarczej sytuacji Kambodży. Następnie przedstawiono niezbędne warunki wstępne dla zrównoważonego rozwoju kraju, a także rekomendacje dla polityki gospodarczej zbieżnej z koncepcją społecznej gospodarki rynkowej oraz dalsze możliwe przeszkody.

***Słowa kluczowe:*** Kambodża, transformacja, zrównoważony rozwój, społeczna gospodarka rynkowa

**JEL:** P20, P40, Q01