

## **Cambodia's Resource-Rich Future**

By Daniel Altman – January 2008

The water off the southern coast of Sihanoukville is so clear that you can see all the way to the bottom, just by leaning out of one of the old wooden boats that shuttle tourists between the tiny islands in the Gulf of Thailand. Even at the height of the tourist season, there's rarely more than one other boat in sight after the ramshackle fishing fleet has come in for the day. But there's something else down there, under the seabed, something that may one day cloud up these waters just as it is already clouding Cambodia's future: oil.

Yes, crude oil. Lots of it. And gas. Experimental drilling began in earnest in 1991 and has recently intensified. Since 2004, Chevron has conducted two exploratory projects with Japan's Mitsui Oil in one zone, which the International Oil Daily estimates to hold 400 to 700 million barrels, and it found the precious hydrocarbons both times. Other energy companies from the region are also involved, including Indonesia's MedcoEnergi and Singapore's China Petrotech, which reported a find of 227 million barrels of oil and 496 billion cubic feet of natural gas in another zone.

Extracting all of the oil won't be easy, as much of it is scattered across several potential drilling sites, but reserves on this scale could easily be worth tens of billions. Then come the minerals, newly discovered back on the Cambodian mainland – probably bauxite, maybe gold and copper – that could be worth billions more in an economy whose annual output is just over \$7 billion.

But wait a minute – this economy of just 14 million people is already growing at lightning speed. After the catastrophe of the Khmer Rouge's genocide, in which hundreds of thousands of the most highly educated and skilled Cambodians died, the country fell into the company of the world's least-developed nations. But the combination of Cambodia's historical treasures, the best known of which are the Angkor temples, with an increasingly stable political situation has jumpstarted the recovery.

Now, with a flood of foreign visitors, a burgeoning garment industry and a couple of good rice harvests, Cambodia has become one of the fastest-growing – and most corrupt – economies in the world. So, what happens when you add potentially enormous natural wealth into the mix? The risks are enormous, both to the upside and the downside.

After the Khmer Rough were driven into the jungle by the Vietnamese army and their local allies in 1978, Cambodia experienced 13 years of Communist-style rule and low-intensity civil war, ending with a peace agreement in 1991 and a transition to democracy under the auspices of the United Nations. Elections were held in 1993, 1998 and 2003, each one marked by less unrest and more transparency than the previous. Hun Sen, a former Khmer Rough cadre who had allied himself to the Communist regime that followed the Vietnamese intervention, quickly carved out a power base and remains the country's prime minister. Real opposition has arisen in the form of Prince Norodom Ranariddh –

a royal scion who once shared the top job with Hun, and now has his own party – and in the more recent appearance of Sam Rainsy, a former finance minister who carries an anti-corruption banner.

For several years, the Cambodian economy was a free-for-all; you grabbed what you could and, as long as you paid off the right people, you faced little regulation of any sort. Corruption is still a fact of life, but the rule of law and the consolidation of the economy are slowly starting to take hold.

Signs of economic progress are nowhere more prominent than in Sihanoukville, also called Kompong Saom. The beachfront Independence Hotel – inaugurated in 1963 with luxurious interiors designed by the now-retired King Norodom Sihanouk himself, but derelict for decades – reopened in May 2007 under the ownership of Canadia, one of Cambodia's major commercial banks. Fences mark off huge tracts of lands being bought up by developers anticipating boom times in Sihanoukville's port, the closest to the oil fields and the major depot for foreign trade.

But pollution is worsening in the water off the north side of Sihanoukville, where the port is located. Poor families cleared out of their modest villages by government forces to make room for new businesses search for new homes along the beaches. And when you ask the locals if they'll benefit from Cambodia's newfound wealth, they shake their heads and offer the same saying, heard again and again: Cambodia's rich are the richest rich, and its poor are the poorest poor.

There's good reason for skepticism. In deprived areas, the appearance of natural wealth has led to tragedy as often as prosperity: in Nigeria, where hundreds of billions of dollars in oil and gas revenue have led to almost zero improvement in the average standard of living; in Sierra Leone, where diamonds became fuel for a horrific civil war; in Sudan, where the government and rebels have destroyed villages across the south as they battle to seize new oil deposits; in Chad, where, even with the oversight of the World Bank, the division of oil revenue led to political turmoil; in East Timor, where impatience with a government's reticence to spend oil money has led to rioting; and even in tiny Equatorial Guinea, where the advent of oil has turned the country into a police state where virtually all the profits apparently accrue to only a few top officials.

The question, therefore, is simple: Will Cambodia be able to avoid the oil curse?

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The first part of the answer comes along the road inland to the capital, Phnom Penh, from Sihanoukville. As the sun sets, buses trundle past huge fluorescently lit garment factories, hundreds of workers dawdling outside after their shifts. Like many poor countries that can usually feed themselves, Cambodia has sought out low-cost manufacturing as an alternative to agriculture. Inside the city, where signs for new high-rises spring up almost as often as new traffic lights, there is an entrepreneurial buzz in the air, from tiny shops selling mobile phone cards to sparkling car dealerships.

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This country is going somewhere, oil or no oil. One of its success stories is Pon Lok, a restaurateur who started with four tables in 1983 on the riverside promenade. He managed to grow to 10 at the end of the Vietnamese-sponsored, Communist-style regime in 1993. Now, he has two floors and an army of waitstaff, mostly children from the countryside who work while going to school. More and more, however, they are returning home as their parents sell land into the speculative boom that's gripping the country.

"The government supports any business, but we have to pay tax on everything," Pon Lok said through a translator. "I never pay any bribes to the government or policemen," he added. "If you do a legal family business, they never come and ask for bribes." His main complaint these days, he said, is the onrush of foreign businesses trying to compete with him for tourists' money.

And as for oil? "I don't care about that," he said. "My business is not concerned with that oil money."

A few blocks away, Chany Tea echoed that feeling. He left Cambodia at age eight during the Khmer Rouge's oppression and spent about two decades in the United States. He became a citizen and worked at a family-owned donut shop in Long Beach, California, then came back to Phnom Penh in 1994. Now, he owns two donut shops in the capital.

"I wanted to come back because I wanted to help the country, show a new thing – a new product – to Cambodia," he said at a table in his shop, which also sells foreign foods and toiletries. "It's easy to do business, not too hard, because the government doesn't have too many regulations," he added. "Cambodia has a very great future, because of all the people investing money. I want to open a warehouse like Sam's Club or Costco. I have the land now. I need a little bit more money, and I will do it."

If oil is on his mind, it's only the kind he uses to fry donuts. "I don't think about it," he said. "That's the government's stuff, not my business."

Indeed, the Cambodian economy has more than doubled in size in the past nine years, said Stephane Guimbert, senior country economist for the World Bank in Cambodia, at the bank's plush offices on Norodom Boulevard, one of the capital's main thoroughfares.

"From an economic point of view, there was a clear transition through that period from a Soviet-style planned economy to a more market-oriented economy. That was gradual from the late 80s through the mid-90s," Guimbert said. "Since 1998, growth has been quite impressive," he said. "The economy has been really very dynamic."

With such a vibrant economy, Cambodia already has an advantage in avoiding the worst of the oil curse. Where some poor countries have greeted the gushing

black goo as manna from heaven, many Cambodians are more interested in their own big plans.

And that's just one factor that could help the country to dodge the bullet. Cambodia is 90 percent ethnically Khmer and 95 percent Buddhist. With the Khmer Rouge utterly discredited and its former leaders now on trial for human rights abuses, there is little scope for the kind of factional fighting that could turn into a deadly war for resources.

But if Cambodia won't end up like Sudan (with its bloody, oil-drenched civil war) or like East Timor (with its unemployed men rioting as oil revenue flows into the government's coffers) where will it end up? For a preview, you need only travel a few hours up the Tonle Sap to Siem Reap, where Cambodia boasts another type of inherited wealth, this time inherited from history rather than from the earth.

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Nothing can really prepare you for a visit to the temples at Siem Reap. The enormity, the complexity and the sheer beauty of the sprawling structures of Angkor Wat, Banteay Srei and their neighbors have inspired religious devotion for over a millennium, and they also inspire the wonder of well over a million tourists every year. Rising out of the surrounding forests, some still wrapped in the vines and roots of the encroaching vegetation, they are Cambodia's emblem. But they are also a business.

Visitors paying the \$20 fee for Angkor Wat, for example, may be surprised to read on their tickets that they have become clients of Sokha Hotels Ltd. The company is a division of the Sokimex Group, whose chairman is the redoubtable Sok Kong, a man whose name is uttered with equal parts of awe, fear, respect and disparagement by Cambodians.

If Cambodia its own Horatio Alger, his subject would be Sok Kong. A Vietnamese immigrant who, it is rumored, started from zero recycling garbage on the streets of Phnom Penh, he built a rubber-processing business in the 1980s and then went into import-export as Cambodia re-emerged onto the international economic scene in the 1990s. With an expert eye for knowing where the money was, Sok Kong soon branched out into tourism... and petroleum. Now Sokha Hotels are ubiquitous in Cambodia's major cities, and Sokimex holds a dominant position in the market for oil and gasoline.

Along the way, Sok Kong became a close associate of Hun Sen, and the men helped each other to rise in their respective fields. It was perhaps no surprise, then, when Sok Kong emerged with the Angkor concession in 1999 after a murky process devoid of competitive bidding. Sokimex pays \$1 million annually for a concession that could be worth \$40 million this year. In fact, Sok Kong received such a sweetheart deal that in 2005, when he claimed that the International Monetary Fund supported the renewal of his concession, an official of the fund

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wrote a vehement letter insisting that the contract be opened to competitive bidding.

The meager revenue received by the government certainly has done little to help the country's poor. On the outskirts of Siem Reap, green rice paddies contrast with red earth roads and clear blue skies. Shoeless children sit in stilt shacks with woven reed walls, picking lice from each others' heads. Families store wood underneath their houses, between the stilts, in hopes of building a more solid home.

A few have managed to construct houses that look like they could withstand the wind and rain of the monsoon season, but it's not because of any overflow from the tourist trade, which hardly exists outside of the temples. Rather, said Samedi So, a local guide, it's the result of peace and good harvests. The children still can't get enough schooling, though, since they have to work on the paddies – as do their teachers.

In the meantime, the town of Siem Reap is exploding with construction and commerce. The airport has a sleek new international terminal, and along the road into town a giant new hotel seems to appear every week, its driveway clogged with tour buses like so many piglets suckling a sow. Boutique design hotels are starting to proliferate, too, both in the center and in the secluded woods around the town. In the tourist market, prices for silks and sculptures are rising.

The contrast is a harsh one, said David Van and Cambodochine Dao, two dapper middle-aged consultants who worked together on a joint export-promotion project of the Commerce Ministry and the United Nations Development Program, over lunch at Phnom Penh's swish Le Royal Hotel. Siem Reap is the best-known province, Van said, and Dao adds that the province receives more aid – partially to restore the temples – than any other.

“And yet, it is one of the poorest,” Van said. “How can you explain that?”

The main reason, according to Van and Dao, is a lack of good governance. Without good governance, Cambodia cannot hang on to the benefits of its historical legacy. And without good governance, whatever benefits Cambodia procures can't be spread widely among the Cambodian people. And these are the very same problems that Cambodia will face as it develops its natural wealth, not only because Sok Kong is sure, as Van predicted, to get his hands on a big chunk of it.

According to Dao, foreign companies have been horning in on businesses that were supposed to stay in Cambodian hands under the terms of its membership in the World Trade Organization, like the cheaper guesthouses around Siem Reap. Only 15 cents of every tourist dollar stay in Cambodia, he says. And Cambodians are partly responsible, as some of them front for foreign companies to help them circumvent the ownership rules.

"This is not a country that is lawless," Van said. "There are plenty of laws. It just seems that the implementation is pretty selective." Paradoxically, that selective enforcement may actually help Cambodia to avoid the chaos that a sudden rush of natural wealth can bring.

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Corruption is a fact of life in Cambodia. In 2007, only 13 countries out of 172 ranked worse than Cambodia in the Corruption Perceptions Index compiled by Transparency International, the world's leading corruption watchdog. An anti-corruption law lay dormant on the legislative table for 13 years until being sent to the Council of Ministers in 2006, where it still sits.

There is no doubt that corruption is costing some poor Cambodians money, opportunities and even their homes. But it could also be a stabilizing force, according to Aaron Bornstein, chief of party for the Mainstreaming Anti-Corruption for Equity project at Pact Cambodia, a local non-governmental organization.

"Natural resources have been used as a pocket bank to make people rich, to make people happy," Bornstein said between sips of coffee at Java, an open-air café popular with expatriates. "This grand corruption to some extent continues to put resources into the system at the higher level," which keeps the heavy hitters who could upset the government satisfied. "It's like the sharks being fed in the fishnet," Bornstein said. "Once you stop feeding them, they may start eating other sharks."

Still, Bornstein pointed out that corruption is stopping many Cambodians from receiving the benefits of the country's boom. Dao's story of foreign companies using local fronts is being repeated across the country, and in uglier ways.

"There's a tremendous amount of land speculation going on right now," Bornstein said. "Land speculators, through nefarious means, work through middlemen and somehow gain legal title to land. While they may not gain title in a transparent way, the title that they come up with in many cases is legal title."

Sometimes the government becomes complicit, too, through its eagerness for developers' money. "People are living happily on their land and think they have ownership of their land, and one day they wake up to guns and soldiers telling them to get out," Bornstein said. Through the end of 2007, there had been at least 29 mass evictions in and around Phnom Penh, according to The Phnom Penh Post.

To combat this trend, the World Bank and other donors have been sponsoring a program that creates 20,000 to 30,000 new land titles every month, Guimbert said. But Cambodia still has a long way to go in combating poverty and inequality. According to the World Bank's figures, living standards for both the rich and the poor rose between 1994 and 2004, and the poverty rate dropped from 47 percent to 35 percent. Yet growth has been uneven, as in many countries

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where the elites are better-equipped to take advantage of the openings offered by globalization.

"You see some signs of very high income in the city, and deep poverty is still a major issue, even in urban areas," Guimbert said. "Everyone is better off, but the richer have benefited more than the poorer."

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This is where the oil, gas and minerals could actually make a difference. Fighting the deepest poverty takes money, to improve public health and education and to build the infrastructure that carries economic opportunity. The quality of education will be especially crucial, since, Van said, about 250,000 new workers are entering the labor market every year. Though Cambodia is already carving out specialty niches in international markets – Dao cited farmers growing organic rice and garment makers touting high labor standards – it will also need a workforce that can attract a diverse range of new industries.

So far, the government is talking the talk. At a conference for foreign investors in November, Deputy Prime Minister Sok An said that oil revenue would be used for "clean water and education," according to a report by The Phnom Penh Post. And Joseph Mussomeli, the American ambassador in Phnom Penh, who has warned vocally and repeatedly of the dangers of mismanaging Cambodia's natural wealth, said he believed Hun Sen's stated desire to prevent Cambodia from becoming "the Nigeria of Asia." But if and when the oil revenue arrives – the government expects \$174 million a year beginning in 2010, though Bornstein said it could be closer to 2012 – walking the walk could be a tougher proposition.

"Clearly there will be huge pressure to spend it quickly," Guimbert said. "Certainly the political pressures will be as high as in East Timor and Chad and other places." Infrastructure has not kept pace with economic development, he said, and business interests will want to see new power plants and roads. In addition, Hun Sen is planning to build a huge oil refinery in Sihanoukville by 2010 – an expense that Dao said he found worrisome. "We have Singapore a stone's throw away that has the most efficient oil refineries in the world," he said. "Why in the world are you going to spend billions of dollars to build your own refinery?"

But Guimbert also pointed to signs of progress. Just a couple of years ago, for example, the government stopped paying employees and contractors in cash and began using the nation's banking an electronic payments system – a simple step, but fundamental for accountability on both sides.

Making sure the oil money flows transparently and into the right investments is only part of the challenge, though. Absorbing an extra \$174 million a year – which could be much more if Australian mining firms working in the eastern province of Mondulkiri can indeed extract bauxite, copper and gold – is no small task for an economy with an annual output likely to be worth about \$10 billion. "It's difficult to argue that it could grow much faster," Guimbert said.

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The effect of this rapid growth is also an environmental concern, especially since Cambodia depends on its natural beauty for much of the tourism outside Siem Reap. "On cultural preservation I think they're much better than on environmental protection," said Joseph Mussomeli, the American ambassador in Phnom Penh, who has warned vocally and repeatedly of the dangers of mismanaging Cambodia's natural wealth. "There are those in the government who are conscious of this, who have the education and the expertise to do something about it. That doesn't mean they will do something about it."

"This is a wide open country," Mussomeli added. "It is like the last frontier in Asia. It's empty because of the genocide and the civil wars, it's virgin forest, and there are lots of hungry foreigners."

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So, what does the future hold? Bornstein said that Cambodia reminded him of another country where he worked on corruption issues: Azerbaijan. When the Iron Curtain fell, Baku had the same sort of Wild West feel that Cambodia did a few years ago – but that has changed, at least a little bit.

"They put some procedures in place to control their oil wealth," Bornstein said. "There was a burgeoning of civil society interests in the oil industry sector." In Cambodia, he added, "you have a lot of serious and committed people, including some within the government, who want to get this right. I don't have this view that just because Cambodia is Cambodia, this will be fuel for the fire of corruption."

That optimism, at least about intentions, was shared by Mussomeli. "Regardless of what you say about these people, most of them are patriots," he said. "From the historical perspective, Cambodia just isn't where it should be. They want to really compete, and they know they can't do that if they just become a little mafia."

"As I jokingly told the deputy prime minister, Sok An, 'We need to make this the most boring country in Asia' – just so the Cambodians can take a breath, and relax."

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