Sunday, December 16, 2012

Dear Prime Minister Sen,

Greetings from the United States. My name is Brian Smith and I am an undergrad student at Temple University, studying economics, more specifically economic development in low-income countries. I have spent much time performing a case study on the Cambodian economy. I am writing to offer a set of suggestions to improve Cambodian economic conditions and help sustain the country's current growth rate of economic growth over the long run. Before I begin, I must commend you and your country for your resiliency, and impressive growth over the past fifteen years. Cambodia is headed in the right direction, but I think we can both agree that problems still exist. My primary concern is the lack of new, dynamic industry. Agriculture, tourism, and garment manufacturing dominate the economic landscape. While this is proving quite effective now, the sustainability of these industries is limited. Without the development of new industries, the current rates of economic growth will slow and eventually stall in the future. Much of the content I will address in this letter involves relatively small policy changes aimed at making the Cambodian marketplace favorable for new developing industries. Cambodia has great potential and can follow in the footsteps of nearby countries, like South Korea and Japan, whom were able to develop from low-income countries into world economic powers in a very short period of time. Cambodia has the opportunity to increase its annual economic growth, and more importantly sustain this growth over the long-term, by implementing a small series of economic policy changes, such as but not limited to, the universal enforcement of property rights, a reduction in government patent exploitation, and the execution of using protectionist foreign trade policy in a few carefully selected industries.

First, a stricter approach towards property rights will go a long way towards securing foreign investment, both direct and portfolio. When discussing property rights one is usually referring to either traditional property rights, involving land and physical property, or intellectual property rights. Both types of property rights play a crucial role in incentivizing foreign investment. In order to avoid confusion, this section on property rights will be broken down into 2 categories, with physical property rights preceding intellectual property rights.

In a traditional sense, property rights involve a citizen's individual rights to own properties, such as land and housing. A country with clear, established property rights allows its citizens to take out loans, putting their property up as collateral. In the absence of adequate property rights, a country's citizens cannot prove ownership of land. Under these circumstances, it is difficult, sometimes impossible, for individual businesses and families to experience growth, in terms of income. In a sense, a lack of established property rights kills the entrepreneurship market, significantly hindering long-term growth.

Currently, property rights in Cambodia are legislatively solid, but the lack of adequate enforcement has become a real problem. According to the *Land Law*, Cambodia's legislature regarding property rights, ownership rights are guaranteed to Cambodian citizens with possession of property (1). However, controversy has emerged resulting from well-publicized government forced evictions. In a 2009 report on Cambodian ownership rights, the Land and Housing Working Group, a Cambodian charity organization, was critical of the *Land Law*, stating, "these provisions are being implemented in an arbitrary manner" (1). I mean not to lecture, but rather stress the importance of guaranteeing and universally enforcing property rights from a standpoint of economic development.

In order to understand the importance of securing property rights, consider a family working a small rice farm. Families like this are quite common in Cambodia. This particular rice farm annually produces about 500 pounds of rice from the family's labor. By keeping a portion of the rice for themselves and trading the remaining rice, the family is able to cover all of their expenses. The farm is self-sustaining, but they do not yield a profit.

With well-established property rights, the family can take out a loan from a bank, offering the house as collateral, and invest in a new plow, for instance. With the new plow, the family is able to double their annual output. The same amount of land is now twice as efficient. However, had the family been unable to prove ownership of the land, the bank would have denied their loan, as the family had nothing to put up for collateral. Without the proof of ownership, the farm would have continued to produce the same amount of rice. Guaranteed property rights increase productivity of individual firms, subsequently growing the country's economy. Property rights will also spur entrepreneurship, in the same way. With the ability to take out a loan, new business will emerge. Cambodia is in need of the development of new industry, outside of agriculture. Guaranteeing property rights is one way to achieve this growth of more dynamic industries.

Based on the typically successful outcomes in countries where strict property rights are guaranteed, my recommendation is to universally ensure Cambodians the right to legally own property. The provisions in the 2001 *Land Law* are sufficient to satisfy these ownership rights requirements. The issue, however, arises in the implementation of these provisions. It is important that these laws be enforced universally, to fully reap the economic benefits of increased efficiency and the development of new business.

Now, it is time to address the other form of property rights. Intellectual property rights are equally important, if not more important, to a developing country's economy. Intellectual property rights include such protections as copyrights, trademarks, and patents. Cambodia has made significant strides in improving the intellectual property protection over the past fifteen years, but certain issues still must be addressed. Strict protection of intellectual property will give foreign companies the incentive to invest, through both foreign direct investment and portfolio investment.

Intellectual property rights, along with all economic matters, are a two-sided issue. Most people would agree that intellectual property rights, in their most basic form, are good for an economy. Protecting a company's livelihood, whether through patents, copyrights, etc., will provide the company with the incentive to work harder, as their reward is greater. However, some economists fear that intellectual property protections actually hinder development when they are too strictly enforced. Korean economist, Ha Joon Chang, argues that tight intellectual property rights block the transfer of knowledge, subsequently impeding development, especially in developing countries where such protected information may be needed most (2).

While I do agree with Chang, to some extent, I think that as a developing country, Cambodia has more to gain by imposing intellectual property rights than it will lose by implementing these measures. For the most part, large companies in developed countries control the knowledge gap, which is protected by intellectual property rights. This knowledge would be particularly helpful for developing countries to have, as suggested by Chang, but the corporations will not share this information with developing countries just because they have agreed to enforce intellectual property rights. There is one downside to implementing intellectual property rights. The Cambodian government must cover the costs of enforcing such protections. However, the benefits outweigh these costs, as implementing and enforcing intellectual property rights will increase foreign invest into Cambodia.

Therefore, I recommend the continued expansion of Cambodian intellectual property rights and the development of more effective means of enforcing these protections. According to a 2010 report by BNG, a Cambodian law firm, trademark law in Cambodia is strong, but other areas of intellectual property law are lacking (3). Patent law is one of the areas that need reformation (3). The clause, allowing government to step in and exploit a patent in order to "promote the public interest", is troublesome. While the purpose of this clause may be admirable, preventing private enterprises from withholding information that would benefit the public in the name of profit, the clause is overly broad. A more specific set of circumstances must be identified in order to allow for the government to intervene and exploit a patent. Letting the government determine what qualifies as "promoting the public interest" at their own discretion presents a dangerous amount of power without any check or balances. The clause itself is not problematic, as it can be useful, specifically in the development of new medical technology and drugs. However, the broad language it is written in may result in the government exploiting patents unnecessarily, which will hurt private companies and the Cambodian economy as a whole. By making small changes in this clause, and strengthening patent law in general, Cambodian companies can pursue the development of new technology without the fear of the government exploitation.

In addition to property rights, trade policy is another system by which economic development most commonly controlled. Trade policy refers to the principles that guide a country's trade with other countries, including both imports and exports. In accordance with its accession to the World Trade Organization, or WTO, in 2004, Cambodia has become increasingly more liberal in its trade policy (4). This movement towards free trade has manifested itself in lower tariffs on imported foreign goods and a reduction in trade barriers, among other common WTO practices.

In theory, trade policy has two opposing extremes. First, there is free trade. Free trade, in its purest form, is the elimination of all trade restrictions that block the movement of goods, services, and money across boarders. Free trade economists boast of the efficiency in a free trade system. Free trade is based upon the fundamental economic principle of specialization of labor. On a global scale, countries with the a comparative advantage in the production of a certain good will produce this good because they can produce the good more cheaply than any other country. The low costs of producing of the good are passed onto the countries importing the good. By importing the foreign good, rather than producing in your own county, prices are comparatively lower. In a perfect free trade system, each country would focus on the production of good(s) for which they had a comparative advantage and import all other goods from foreign countries. The reduction of trade barriers allows goods to easily travel across boarders, matching producer and consumer at the lowest price possible through supply and demand.

On the other side of the spectrum, exists protectionism. Protectionism results when a country places restrictions on foreign trade, in order to protect domestic industries from foreign competition. In essence, protectionism is the opposite of free trade. Protectionist economies often receive criticism, especially at the hand of Western free trade economists. However, it is important to recognize the advantages of restricting international trade, especially in developing nations. Protectionist policy allows a country to shelter domestic industries that would otherwise be crushed if the free trade gates were swung open. For example, consider a country with a developing automobile industry. The individual automobile firms have determined a way to build quality vehicles, but their costs of production are high. Due to the price of the vehicles, they will not be competitive in the international marketplace. With a free trade policy, the firms will go bankrupt, jobs will be lost, and the country's economy will contract. On the other hand, by implementing protectionism and imposing high tariffs on imported foreign cars, the country's consumers will buy from the domestic companies. Sure, the consumers will be forced to pay a higher price for a new car, but the large-scale benefits often outweigh these increased prices. Protecting certain industries, in their early stages, such as the developing automotive industry given in the example, will increase the productivity of individual firms they reach the until the point where they can compete on the international market, at which time the tariffs can be reduced or absolved completely. In fact, Toyota was able to develop into one of the most powerful automobile manufacturers in the world as a result of the infant industry protectionism practiced by Japan during the second half of the twentieth century (2).

While both sides may seem compelling, neither extreme will make for sustained long-term growth in Cambodia. Cambodia currently employs a system of free trade with some restrictions in effect to help shelter parts of the Cambodian economy. Cambodia has drastically reduced tariffs on imported goods, following the World Trade Organization involvement. The highest tariff rates dropped from120% pre-WTO to 35% post-WTO. Furthermore, the highest 35% tier only applies to a small selection of processed goods, such as meat and dairy products and tobacco (4). In a developing nation, such as Cambodia, a mixture of free trade and protectionist policy is a good general strategy to promote growth; therefore, the elimination of trade restrictions over the past decade are a step in the positive direction. However, certain alterations to Cambodian trade policy could further expand development and help ensure long-term growth.

As previously stated, the development of new dynamic industries is one of the main challenges hindering long-term growth opportunities in Cambodia. Agriculture and cheap garment manufacturing are industries that typically reside in low-income nations. An effective way to develop new industry is by protecting them from foreign competition in their infant stages. Therefore, it would be advantageous to expand the 35% imported goods tariff to include products and services in developing industries, possibly further protecting them by imposing other protectionist trade measures. Japan and South Korea are two countries that have had great success in the past 50 years, in sheltering specific industries until they were productive enough to compete internationally. Technology will likely have to be imported from foreign nations to effectively develop these new industries.

Although this may sound simple enough, it is important to spend a great deal of time determining which industries to apply infancy protectionism to. Failing to select industries with long-term viability may result long lasting economic difficulty. Additionally, as a result of protecting infant industries, the price for these goods or services will increase domestically. This means Cambodian citizens will have to pay more for whatever products are being protected. If these price changes are significant, expect public resistance. It is important make your intentions clear to the citizens, helping them understand the long-term benefits. Public backlash against government-sanctioned economic policy can result in some nasty consequences, often driving a wedge between the state and its citizens. Another potential problem is the World Trade Organization's involvement. One of the WTO's missions is to eliminate trade barriers worldwide; therefore, they are unlikely to support such protectionist policy. However, Cambodia's strict compliance with WTO regulations, since their 2004 accession, should help the ease the negotiation process. Cambodia may be forced to remove trade restrictions in other areas in order for the WTO to grant the country permission to protect the development of new industries.

In summary, Cambodia's implementation of these policy suggestions is likely to result in a more stable, dynamic economic with the ability to sustain its growth for decades to come. By universally enforcing the property rights set forth in Cambodia's *Land Law*, ordinary Cambodian citizens will be able to put their property up as collateral and receive loans. This will increase productivity of firms and individual households alike, along with sparking entrepreneurship, ideally resulting in the development of new industries. By removing, or otherwise eliminating, the clause in Cambodian patent law allowing the government to exploit patents in order to "promote the public interest", companies will feel safer in developing new technology, thus encouraging foreign investment and domestic investment alike. Finally, adding protectionist policy provisions into Cambodia's increasingly liberal foreign trade policy, new industries will be sheltered from international competition in their infant stage of development. These new industries, other than agriculture, garment manufacturing, and tourism will be vital to the long-term expansion of the Cambodian economy. The recent improvements in the Cambodian economy, education system, and medical fields, matched with the suggested policy changes laid forth in this letter, will allow Cambodia to grow and achieve long-term prosperity, similar to that of neighboring countries like Japan and South Korea.

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