The frontier economy of Cambodia

Global growth is slowing down. Deepanshu Mohan considers frontier economies and why they are attractive to foreign investors

With the global economic landscape experiencing a long deflationary cycle in prices combined with declining productivity levels and a graduated stagnation in real wages, even large emerging market economies like Brazil, China, and India have been experiencing a structural downturn for some time now.

Double-digit growth in emerging markets has almost reached an impasse, which is pushing more countries and multinational companies to explore trade and market opportunities for investment in nations that are low on income but high on economic and political risk. We can refer to these as frontier economies.

Frontier economies are characterized by neo-patrimonial forms of political systems, representing fragile institutional capabilities due to weak land, labour laws, poor contract enforcement systems, and have relatively poor human-capital development levels. These include nations like Cambodia, Rwanda, Myanmar, Mozambique-to cite a few.

Still, most of these economies are attractive destinations for 'deeper' market integration due to rich base of their natural endowments (minerals, metals, oil etc.), fertile agricultural terrain, cheap land costs, which allow many foreign companies to enjoy higher domestic gains, if they get there first.

Moreover, most of these nations, being less integrated with rest of the world, remain more or less unaffected by global economic considerations and thus, offer MNCs significant returns from their first-mover advantage. With slightly lower costs of production and availability of cheap labour, interested companies tend to also create value-added networks for production and compete on value from rapidly growing underdeveloped sectors.

Let's take the case of Cambodia. The Cambodian economy, as one of the top ten fastest growing economies over the last 15 years has clocked an average growth rate of above 7.5%. The economy, which sleepishly depended on tourism for most of its economic revenue and activity, has seen a remarkable diversification in sectoral growth over the last decade or so, with a sharp rise in flow of foreign investment (largely from China) in sectors of hotel and accommodation, construction, real estate (to mention a few).

Other multinational companies, from countries like Japan, Singapore are also seeing how Cambodia's economy and real estate sector with a rising middle-income class offers great long-term opportunities for investment.

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A 200 million USD$ Japanese built Aeon Mall opened its doors in 2014 where one can see a huge number of higher middle-income class Cambodians strolling and shopping. Like Aeon Mall, Bodaiju, a joint venture between a local developer and Japan's Creed Group, is also targeting Cambodia's booming higher middle-class. When completed, Bodaiju's development will feature 928 units set in leafy grounds including amenities such as rooftop pools, a gym, clubhouse, mini-marts and cafes.

With the completion of new airports around the coastal (industrial) city of Sihanoukville and the tourist town of Siem Reap, tourism sector may continue to stay dominant, while allowing an inter-sectional growth of related sectors (transport, communication, hotel etc.) to benefit from this.

As a frontier economy, Cambodia also enjoys a demographic dividend at this point, with 60% of its workforce under the age of 30. Most of the relatively less skilled youth and lower middle income class are desperate for new economic opportunities and China's pro-active presence in this ASEAN country through massive state-directed investments has aided the creation of new business opportunities across sectors not only for Cambodians but also for the Chinese, who are migrating in huge numbers to provincial parts of Cambodia. Sihanoukville almost appears to be a Chinese town or one colonized by the Chinese companies.

Further, in the South-East Asian region, Cambodia offers perhaps the best prospects for investments in real estate infrastructure. Weak land laws further allow foreign investors to bet big on the Cambodian land market too, where one can purchase properties in peripheral areas around Phnom Penh for $1,000 per m^2. or less. Real estate in parts around the capital city of Phnom Penh can range from as little as $150 per m^2 to as high as $9,000 m^2. Properties can very easily be converted to residential spaces that has an attainable 6-8% rental yield and 1% – 5% capital growth.

But how vulnerable is a frontier market like Cambodia? For one, an overt dependence on foreign capital (especially China) makes any economy like Cambodia extremely vulnerable to a capital account crisis in the event of a massive capital flight (or outflow of 'hot' money as it is referred to sometimes). China is already witnessing a slowdown and a liquidity crunch there may destroy Cambodia's credit market (as most banks are dependent on Chinese money).

Macroeconomic fundamentals of frontier economies like Cambodia offer a perfect illusion for investors to park high sums of money in reserve currencies across sectors and (re)invest it elsewhere where returns are higher, or if there is a political crisis, one might see a similar exodus of foreign-money out of the country.

Also, despite high GDP growth, Cambodia's productive competitiveness in areas of manufacturing and overall commodity exports remains extremely weak, especially in comparison to neighbouring countries like Vietnam and Thailand. Its own currency is very fragile and most transactions, including investment of large sums and banking withdrawals happen in USD$.

In areas such as the property market and real estate commercial projects, where large MNC sourced investments are finding way, Cambodia's Ministry of Land Management, Urban Planning and Construction, in a report in 2015, states that most building projects have been initiated without ministry authorization and do not conform to various safety codes. There is then the problem of an over-supply of foreign investment and construction projects and very little demand due to the domestic macro-economic fundamentals being shaky and incomes being low.

It may be prudent to point out how, in spite of recording a higher growth rate and witnessing a bulk capital inflow from foreign markets, frontier economies like Cambodia operate at the edge of a crisis, and so, while developed economies can see these as new sources and avenues for deeper economic integration, frontier economies may need to be aware of the vulnerability they share. ■

Deepanshu Mohan is Associate Professor and Director, Centre for New Economics Studies. He is a Visiting Professor to Department of Economics, Carleton University, Ottawa (Canada) and a Visiting Senior Research Fellow to Paragon International University, Phnom Penh (Cambodia)