



## Legal Development Along the Belt and Road: How Extra-Legal Institutions Shape Foreign Investment and Development Prospects in Cambodia

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### Key Points:

- In Cambodia, illicit financial transfers and informal relationships determine the government's regulation of foreign investors.
- Barring exceptional circumstances, investors' legal standing before the government is achieved through corrupt transactions - posing a legal dilemma for all foreign investors, but a particularly salient one for investors and regulators from the People's Republic of China given the state's sponsorship of outbound investment via the Belt and Road Initiative.
- These practices surrounding foreign direct investment militate against Cambodia's inclusive development prospects in the immediate future.
- How foreign investors explain their role in this system demonstrates that many public and private development agents believe some bribery is harmless and even valuable.

### Introduction

The Belt and Road Initiative's (BRI) ambition lies in its high valuation and its championing of foreign direct investment (FDI) in high-risk jurisdictions under the banner of South-to-South cooperation.<sup>1</sup> However, the qualitative and quantitative expansion of People's Republic of China (PRC) overseas investment under the BRI raises concerns about the effects of FDI on host countries with weak institutions.<sup>2</sup>

Several scholars have addressed the nature and consequences of the interaction between PRC investors and host country institutions in the BRI era, typically through studying exported investor practices.<sup>3</sup> Fewer have thoroughly examined local institutions with which foreign investors work upon arrival, considering how these institutions also shape outcomes for BRI projects.<sup>4</sup>

<sup>1</sup> Andrew Chatzky & James McBride, *China's Massive Belt and Road Initiative*, COUNCIL ON FOREIGN RELATIONS (last visited Jul. 23, 2020), <https://www.cfr.org/background/chinas-massive-belt-and-road-initiative>.

<sup>2</sup> As Matthew S. Erie observes, the BRI includes "some of the most fragile countries in the world, according to world

transparency indicators," making investment projects susceptible to heightened political, economic, and legal risk. Matthew S. Erie, *Chinese Law and Development*, 62 HARV. INT'L L. J. 51, 78 (2021).

<sup>3</sup> Jacob J. Lew et al., *China's Belt and Road Implications for the United States*, Independent Task Force Report No. 79, COUNCIL

Utilizing Cambodia as a case study, this Research Brief (RB) examines the mechanics of the interactions between foreign investors and host country institutions, considering the consequences of this interaction for development prospects.

Drawing on ethnographic fieldwork and interviews conducted between 2019 and 2021, we observe that business-as-usual consists of possibly small, yet illicit, payments made to officials at all levels in exchange for approval, operational latitude, and, sometimes, protection and preferential access to resources. We argue that this dynamic - in which legal status before the government is achieved through unlawful transactions<sup>5</sup> - militates against inclusive development outcomes and poses a dilemma for all investors, but is a salient one for PRC investors and regulators given the PRC's sponsorship of outbound investment via the BRI.

### **Cambodia's regulatory and institutional framework: In theory and practice**

#### *Formal institutions*

The Cambodian government's regulation of inbound foreign investment is headed by the Council for the Development of Cambodia (CDC, hereinafter "the approval body").<sup>6</sup> Chaired by the

Prime Minister, the CDC has operated since 1994 as a "one-stop-shop" to evaluate large-scale investments and to "provide generous[,] competitive incentives."<sup>7</sup> Provided to approved Qualified Investment Projects (QIPs), incentives include an array of tax, import duty, and profit repatriation exemptions lasting several years.<sup>8</sup> The approval body also assists investors applying for general and operational licensing.<sup>9</sup>

Investors rarely circumvent the approval body, due to the centrality of incentives to enterprises' profitability and ability to compete. A government interviewee confirmed "all the big projects" apply for QIP status because "they need the incentives in order to be financially viable and competitive,"<sup>10</sup> a pattern confirmed by other sources.<sup>11</sup>

#### *Informal institutions*

In practice, the formal process is almost always complemented by extra-legal, unethical practices. These operate to galvanize government action, as officials almost exclusively service those conferring direct or indirect personal benefit or referred by an informal network. As one lawyer stated, "If either you or I just walked up to the ministries and tried to apply for something or have a business feasibility consultation, they wouldn't know what to do with us."<sup>12</sup> Although

ON FOREIGN RELATIONS (2021), [https://www.cfr.org/report/chinas-belt-and-road-implications-for-the-united-states/download/pdf/2021-04/TFR%20%2379\\_China%27s%20Belt%20and%20Road\\_Implications%20for%20the%20United%20States\\_FINAL.pdf](https://www.cfr.org/report/chinas-belt-and-road-implications-for-the-united-states/download/pdf/2021-04/TFR%20%2379_China%27s%20Belt%20and%20Road_Implications%20for%20the%20United%20States_FINAL.pdf); Aaron Halegua, *Where is China's Belt and Road leading international labour rights? An examination of worker abuse by Chinese construction firms in Saipan*, in THE BELT AND ROAD INITIATIVE AND GLOBAL GOVERNANCE 225 (Maria Adele Carrai & Jan Wouters eds., 2020).

<sup>4</sup> CHING KWAN LEE, THE SPECTER OF GLOBAL CHINA: POLITICS, LABOR, AND FOREIGN INVESTMENT IN AFRICA (2017), provides one such study.

<sup>5</sup> See Criminal Code, art. 278, 279, 280, 281, 517, 518, 528, 594, 605, 637, 638, 642, Nov. 30, 2009, (Cambodia). See also United

Nations Convention Against Corruption, Dec. 9, 2003, 2349 U.N.T.S. 41.

<sup>6</sup> *Who We Are*, COUNCIL FOR THE DEVELOPMENT OF CAMBODIA (Jul. 23, 2020), <http://www.cambodiainvestment.gov.kh/about-us/who-we-are.html>.

<sup>7</sup> *Id.* Here, large-scale investments refer to those valued at more than one million U.S. dollars.

<sup>8</sup> SOK SIPHANA & MATTHEW RENDALL, LEGAL ASPECTS OF DOING BUSINESS IN CAMBODIA 108-9 (2018).

<sup>9</sup> *Id.*

<sup>10</sup> Interview in Cambodia (Dec. 19, 2019). All interviews cited herein are anonymized to protect identities.

<sup>11</sup> Interview in Cambodia (Nov. 22, 2019); Interview in Cambodia (Nov. 29, 2019); Interview in Cambodia (Dec. 2, 2019).

<sup>12</sup> Interview in Cambodia (Nov. 29, 2019).

the type of bribe and conveyance method vary, these ubiquitous practices are frequently supported by intermediaries, including law firms and business partners, with knowledge about, and longstanding connections to, the bureaucracy and domestic dispute resolution mechanisms.<sup>13</sup>

The approval body has gained a particular reputation for operating exclusively on the basis of illicit payments, to the extent that many lawyers help clients prepare documents, but refuse to attend meetings with the body for fear of liability.<sup>14</sup> One acknowledged, “when you submit to [the body], if you double the official fee, your application will get approved. They ask for \$500? Send \$1,000.”<sup>15</sup> Another lawyer referred to working with the body as “a traumatic experience,” in which officials deliberately slowed processing to induce the client to hire a consultancy owned by a senior official’s spouse.<sup>16</sup> Meanwhile, a provincial business association noted domestic businesses find accessing the body’s services difficult given “unfair competition with businesses paying ‘no receipt’ fees.”<sup>17</sup>

Beyond registration, demands for informal payments follow investors throughout operations and dispute resolution.<sup>18</sup> For instance, a foreign-owned factory employee reported, “There is corruption everywhere. When the inspector

comes by, my boss negotiates, explaining he couldn’t achieve compliance because of extenuating circumstances. The inspector agrees to ‘let them go this time’ for a certain price. Very regular.”<sup>19</sup> Another interviewee shared, “Going to court is a matter of who wants to pay more to the judge to win a case.”<sup>20</sup> While senior lawyers formulate cases’ “grand strategy,” “local counsels” pass bribes to judges.<sup>21</sup> Ultimately, bribes can result in regulatory passivity or proactive, even militarized, protection.<sup>22</sup>

Entering a market dominated by systemic informality forces investors to choose one or more mitigation strategies: (1) cancelling a project; (2) resorting to bribes in exchange for legal status and security; (3) investing without pursuing registration, hoping local enforcement capacity is sufficiently weak to allow a period of profitable commercial activity; or (4) leveraging diplomatic assistance for oversight of government interactions. It remains evident investors, more often than not, resort to unlawful mechanisms to recover certainty not offered by formal institutions.<sup>23</sup>

This environment produces several negative development consequences. First, illicitly enriched officials have diminished incentives to dutifully utilize public office. Second, and related

<sup>13</sup> Sokphea Young, *China’s Belt and Road Initiative: Patron-Client and Capture in Cambodia*, 8 *CHINESE J. COMPAR. L.* 414 (2020) <https://doi.org/10.1093/cjcl/cxaa025>; Interview in Cambodia (Jan. 18, 2020); Interview in Cambodia (Feb. 24, 2020).

<sup>14</sup> “I prepare documentation, but never attend meetings. There is a lot of corruption and government fees without receipts. I want to stay out of it.” Interview in Cambodia (Nov. 22, 2019).

<sup>15</sup> Interview in Cambodia (Jan. 20, 2020).

<sup>16</sup> Interview in Cambodia (Dec. 2, 2019).

<sup>17</sup> Interview in Cambodia (Jan. 17, 2020).

<sup>18</sup> Interview in Cambodia (Dec. 4, 2019); Interview in Cambodia (Feb. 24, 2020). Tax officials have earned a particular reputation for arbitrary enforcement and illicit enrichment. One lawyer

stated regulators find issues with tax filings “one-hundred percent of the time” resulting in heightened fee collection, despite the accuracy of previous filings. Interview in Cambodia (Feb. 23, 2020).

<sup>19</sup> Interview in Cambodia (Feb. 23, 2020).

<sup>20</sup> Interview in Cambodia (Jan. 18, 2020); Interview in Cambodia (Feb. 24, 2020); Interview in Cambodia (Dec. 4, 2019).

<sup>21</sup> Interview in Cambodia (Nov. 7, 2019).

<sup>22</sup> One executive in a large-scale, foreign-owned project claimed having “a hotline to the most feared brigade of the Cambodian army...in case anything should happen.” Interview in Cambodia (Feb. 12, 2020).

<sup>23</sup> Interview in Cambodia (Jan. 16, 2020); Interview in Cambodia (Dec. 4, 2019); Interview in Cambodia (Jan. 20, 2020).

to this, prospects for corporate oversight are weakened, which can be disastrous and lethal, especially in construction, energy, or civil engineering projects.<sup>24</sup> Third, wealthier, internationally mobile investors have greater impunity than domestic counterparts operating in legal jeopardy and privileged access to regulators, given the unrecorded payments' inflation of the cost of doing business.

### The relationship between law and development

The investors' role in strengthening or diminishing corruption - and how they comprehend that role - requires further evaluation, given its direct impact on development outcomes. Although participation in bribery from any angle (e.g. payer, recipient, intermediary) violates Cambodian and transnational laws, investors rationalize their role with some variation along a spectrum. At one end, 'reluctant participants' acknowledge the harmfulness of bribes, yet emphasize their lack of agency in official interactions, raising questions of who can be expected to risk mounting resistance to extractive institutions.<sup>25</sup> At the other end, investors assert corruption can be ethically valuable, given its facilitation of growth in host economies.

Unlike other interviewees, PRC investors uniquely emphasized a need to practice humility, "respect

local practices," and avoid intervention - suggesting private investors have internalized a discourse of PRC foreign policy.<sup>26</sup> Despite deploying non-interventionist discourse, PRC firms were some of the only private investors we encountered that creatively implemented capacity-building and whistle-blowing programming. One program aimed to reduce corruption within a firm's sphere of operation, interestingly, by replacing illegal informal mechanisms like bribes, with lawful informal mechanisms, such as the firm's establishing a personal relationship with a senior official to report petty bribe solicitations.<sup>27</sup>

In Cambodia, many agents of development assert bribery's harmlessness and value, raising a familiar debate in law and development scholarship - between those who advocate for establishing sound institutions prior to allowing capital to flow freely and those who argue the conditions of a more advanced economy are a precursor for developing rule of law.<sup>28</sup>

The stakes of the debate for a developing nation like Cambodia complicate the issue. New infrastructure and commerce via FDI generate concrete improvements to livelihoods, regardless of compromises made to realize projects. Conversely, reinforcing informal institutions through FDI can cause long-term costs, as

<sup>24</sup> See Sun Narin, *After Cambodia's Building Collapse, More Construction Sites Found "Without License,"* VOICE OF AMERICA CAMBODIA (Jul. 23, 2020), <https://www.voacambodia.com/a/after-cambodia-s-building-collapse-more-construction-sites-found-without-license/4978044.html>.

<sup>25</sup> As Professor Kevin E. Davis observes, "people accused of paying bribes often complain that they are victims rather than perpetrators of crime...[and that] the real perpetrators are the public officials who use the power of their office to extract bribes." KEVIN E. DAVIS, *BETWEEN IMPUNITY AND IMPERIALISM: THE REGULATION OF TRANSNATIONAL BRIBERY* 104-5 (2019).

<sup>26</sup> Interview in Cambodia (Jan. 16, 2020); Interview in Cambodia (Jan. 20, 2020). Although this ethos could be interpreted as

shirking complicity, these investors explain themselves as promoting mutually-beneficial growth, while manifesting humility in quietly advocating for legal reform through consultative suggestions rather than demands.

<sup>27</sup> *Id.*

<sup>28</sup> For examples of critical approaches to corruption studies, see Nathaniel Leff, *Economic Development through Bureaucratic Corruption*, 8 *American Behavioral Scientist* (1964), Colin Leys, *What is the Problem About Corruption?*, 3(2) *JOURNAL OF MODERN AFRICAN STUDIES* (1965), and Pierre-Guillaume Meon & Laurent Weill, *Is Corruption an Efficient Grease?*, 20 *BOFIT Discussion Papers* (2008).

governance is systemically weakened, projects operate unsustainably, and public resources are expropriated. For resource-limited states with fragile economies, openness to investment may exacerbate exploitative governance without providing sufficient relief.

### Recommendations

Several measures could help build a future in which investing in Cambodia does not present a choice between economic and legal development. First, foreign investors should attend meetings accompanied by diplomatic representatives to minimize private interactions with officials. Second, foreign corrupt practices should be more heavily prosecuted by the PRC and other states.

Third, Cambodia and development partners should continue to invest in e-government initiatives centralizing, digitizing, and transparently disclosing government operations.<sup>29</sup> These actions could generate meaningful improvements for foreign investors' property rights, Cambodia's sustainable development, and coherence between the BRI's mandate and its impact.

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<sup>29</sup>See Molly Bodurtha, *Cambodian Perceptions of the Digital Silk Road*, in *THE DIGITAL SILK ROAD: PERSPECTIVES FROM AFFECTED COUNTRIES*, LIEDEN ASIA CTR. 6, 12-13 (Rogier Creemers ed., 2021). The approval body keeps very limited public records. For instance, no QIP database listing QIPs, let alone their application materials and EIAs, exists. (Telegram

communication from approval agency official, Feb. 12, 2020.) The approval body could demonstrate the integrity of its incentive program by allowing the Cambodian public—the program's de facto stakeholders—the ability to assess development promises and outcomes for themselves.