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The Questionable Legality and Prospects of Chinese Hydropower Dam Investments in Cambodia

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Key Points:

- The Cambodian People's Party (CPP) government and Chinese state-owned enterprises (SOEs) have exploited Cambodia's weak rule of law in various ways to improperly obtain mutual benefits in hydropower contracts.
- The Cambodian people and opposition parties have a strongly negative perception of these investments, especially the irregular arrangements between the CPP and Chinese SOEs.
- Therefore, the success of hydropower investments in the longer-term could be jeopardized if a different government is formed in Cambodia.

Introduction

Of Cambodia's seven hydropower dams, six have been built by Chinese state-owned enterprises (SOEs) since 2009.¹ This Research Brief aims to examine the perceived unlawfulness and institutional exploitation behind these projects

and the potential implications for the projects' future success. It will then provide recommendations to help ensure the long-term prospects of hydropower investments.

My central thesis is that both the incumbent Cambodian People's Party (CPP) government and Chinese SOEs have exploited Cambodia's weak rule of law in various ways to improperly obtain mutual benefits in hydropower contracts. The Cambodian people and opposition parties have a strongly negative perception of these investments, especially the irregular arrangements between the CPP and Chinese SOEs. Therefore, the success of investments in hydropower in the longer-term could be jeopardized if a non-CPP government is formed.

CPP and Chinese SOEs – Exploiting Cambodia's Weak Rule of Law

Across all seven hydropower projects in Cambodia there is a common thread in how the deals have been structured. A Chinese SOE will receive initial funding from Chinese state banks to procure the

¹ Cheang Sokha & Sebastian Strangio, *PM opens Kamchay dam*, THE PHNOM PENH POST (Dec 8, 2009),

<https://www.phnompenhpost.com/national/pm-opens-kamchay-dam>

construction project.² Under a Build-Operate-Transfer (BOT) contract, the SOE has complete control and responsibility to build the dam and then to operate it for 30 to 50 years.³ During the dam's operation, the SOE will receive revenue from Cambodian state utilities for the sale of electricity. Once the operation phase ends, the SOE will transfer the dam to the Cambodian government. In a BOT contract, operational risks are typically borne by the contractor, which would be the SOE. Such risks include financial losses due to government changes and revenue shortages. However, for *all* Chinese-financed hydropower projects in Cambodia, Chinese investors have ameliorated such risks in various ways. My argument is that both the incumbent CPP government and Chinese SOEs, with the backdrop of strong bilateral Sino-Cambodian ties, have exploited the weak rule of law in Cambodia to improperly obtain mutual benefits in the hydropower deals.

The SOEs' hydropower investments in Cambodia are undergirded by Chinese state government (CCP) support. The state actively encourages outward investments by SOEs, which are given financial incentives to invest abroad as part of China's "going out" (*zou chuqu*) policy. The Chinese state provides particularly strong support for (hydropower) projects in Cambodia⁴ due to the strong bilateral Sino-Cambodian relationship, fostered by Chinese investment and aid. Since

hydropower investments are as much a manifestation of Sino-Cambodian political relations as they are economic relations, both the Chinese and Cambodian governments have an interest in the investments' success. Strong Sino-Cambodia ties, which deter defection from the CCP government and encourage favouritism by the Cambodian government towards the CCP, incentivises Chinese SOEs to invest in hydropower projects.

Nonetheless, SOEs *per se* are willing to make hydropower investments in Cambodia, despite the latter's extremely weak rule of law.⁵ Such an investment climate gives SOEs the ability to exploit Cambodia's weak legal institutions to ensure the success of the hydropower investments.

Firstly, Chinese SOEs tap Prime Minister Hun Sen's authority over Cambodia's weak government ministries to receive approval to commence hydropower projects in Cambodia through the back door. Despite Cambodian law requiring an Environmental Impact Assessment (EIA) to be undertaken before construction, projects have often commenced before an EIA has been completed.⁶ Because Hun Sen ultimately decides whether a foreign company is given approval to build a hydropower dam, ministries managing the approval of hydropower projects must disregard the enforcement of water resource and

² Daniel O'Neill, *Playing Risk: Chinese Foreign Direct Investment in Cambodia*, 36(2) *Contemporary Southeast Asia: A Journal of International and Strategic Affairs*, 185 (2014).

³ Shahar Hameiri, *Cambodia's electric Chinese aid and investment affair*, EAST ASIA FORUM, (July 27, 2019), <https://www.eastasiaforum.org/2019/07/27/cambodias-electric-chinese-aid-and-investment-affair/>

⁴ DANIEL O'NEILL, DIVIDING ASEAN AND CONQUERING THE SOUTH CHINA SEA: CHINAS FINANCIAL POWER PROJECTION 117 (2008).

⁵ Cambodia is ranked 125th out of 126 countries. *World Justice Project Rule of Law Index 2019*, World Justice Project (2019) <https://worldjusticeproject.org/sites/default/files/documents/ROLI-2019-Reduced.pdf>

⁶ For example, while the construction of Kamchay Dam began in 2006, the finalized EIA report was not approved by the Ministry of Environment until September 2011. Mark Grimsditch, *China's Investments in Hydropower in the Mekong Region: The Kamchay Hydropower Dam*, *International Rivers* 1, 6.

environmental laws to accede to Hun Sen's decision.⁷

Secondly, Chinese SOEs have exploited Cambodia's weak rule of law in that Hun Sen's exercise of power over other legal institutions has enabled him to amend Cambodian laws, such that Chinese hydropower investors are guaranteed payment. The National Assembly, supposedly Cambodia's law-making body, is actually largely a 'rubber-stamp' body.⁸ The pliant judiciary, composed of many CPP politicians, is unlikely to check Hun Sen's decision to enact these payment guarantees. Indeed, for *all* Chinese-financed hydropower projects in Cambodia, the CPP-led government has legally guaranteed long-term payment to Chinese SOEs by enacting new legislation. For example, when Kamchay Dam was built, the National Assembly enacted legislation that guaranteed payment to Chinese SOE Sinohydro for the entire 44-year duration of the BOT contract with the Cambodian government.⁹

Another pertinent feature of these guarantees is that they protect Chinese investors from the uncertainty created by a political regime change. For example, when contracts to build the Stung Tatay and Stung Russey dams were entered into, the National Assembly passed legislation to guarantee the Chinese SOEs against potential losses caused by 'political incidents.'¹⁰ Therefore, if a political regime replaces the CPP, this new regime must continue to enforce the guarantee (although it is questionable whether a non-CPP government would actually enforce these guarantees that it did not commit to). If the new regime that governs Cambodia is less supportive

of Chinese (hydropower) investments, it will be less likely to uphold the legislative guarantees that have been enacted by the CPP.

Furthermore, the payment guarantees are unique in the sense that the "guarantor," that is, the Cambodian government, is not distinct from the "guarantee," Electricite du Cambodge, Cambodia's state-owned power company. The Ministry of Finance must pay Chinese SOEs if Electricite du Cambodge does not purchase the output. Another distinct feature is that while typical legal guarantees are contractually stipulated, Chinese hydropower guarantees are legislatively enacted. Therefore, they do not involve any form of security such as pledges, charges or mortgages; the SOEs thus rely on the Cambodian government to enforce payment.

On the other hand, the CPP government has been complicit in allowing Chinese SOEs to exploit Cambodia's weak legal institutions in order to accommodate hydropower investments. The reason behind the CPP's acquiescence is a political one. Their provision of the aforementioned benefits and favours to SOEs attracts hydropower investments. By facilitating an increase in crucial infrastructure such as hydropower dams for the benefit of Cambodian citizens, the CPP can increase its political legitimacy. This is a performance-centric legitimacy, based upon the development of key infrastructure that provides citizens with important amenities. In this regard, hydropower dams constitute a crucial part of infrastructure development *vis-à-vis* enhancing Cambodia's energy access. This argument is supported by the fact that infrastructure 'gift-

⁷ O'Neill, *supra* note 2, at 182-183.

⁸ O'NEILL, *supra* note 4, at 119.

⁹ O'Neill, *supra* note 2, at 188.

¹⁰ Vong Sokheng, *Funding Law Approved for Hydropower Dams*, THE PHNOM PENH POST, (Jan. 2, 2009), <https://www.phnompenhpost.com/national/funding-law-approved-hydropower-dams>

giving' has been a consistent, longstanding and effective vote-mongering strategy of the CPP. Since Hun Sen took over as co-Prime Minister in 1993, gift-giving strategies by the CPP to garner votes have been ubiquitous.¹¹

Ultimately, the exploitation of Cambodia's weak rule of law in hydropower investments seems to have provided a win-win situation for both the CPP and Chinese SOEs. The SOEs have contributed to the CPP regime's political support by financing infrastructure development projects, such as hydropower dams. The CPP, if firmly in power, ensures that hydropower investments are profitable and well-protected, and that SOEs continue to receive favourable investment terms.

Cambodia Populace and Opposition Parties – Hostile Attitudes

On the other hand, the Cambodian people and opposition party members have a strongly negative perception of hydropower investments, especially with respect to exploitative arrangements between the CPP and Chinese SOEs. Many Cambodians are aware, and indeed critical, of the illegal and underhanded political dealings involved in hydropower dam investments. They often associate hydropower projects with widespread corruption, poor governance, opaque deals and unlawful arrangements.¹² Furthermore,

the recent perception among the Cambodians is that the dams do not actually benefit the citizens. My interview with a villager living in Kampong Speu province revealed that most villagers in that community are unhappy with the nearby Kirirom 1 Dam because they received no apparent benefit, such as increased access to electricity.¹³ Similarly, villagers living near to Kamchay Dam complained that they still suffered from a lack of access to electricity even after the dam was constructed.¹⁴ Overall, local communities surrounding the dams are resentful towards the Chinese SOEs because of the adverse impact on their livelihoods, and the absence of fair compensation for, for example, access and resources.¹⁵

Similarly, Cambodia's opposition party members are generally hostile towards Chinese investments. Sam Rainsy, the leader of the opposition, has criticised the investment deals between Chinese SOEs and CPP officials as "corrupt."¹⁶ Son Chhay, another opposition leader, has characterised Chinese investors as "aggressive business people who capitalise on Cambodia," and who are "given special rights by the government that invariably agrees with they want."¹⁷ It is pertinent to note that the opposition's disapproval of Chinese investments in Cambodia is mainly targeted at their unlawfulness (which both the SOEs and the CPP are guilty of). This is a criticism that echoes

¹¹ Robin Biddulph, *Can elite corruption be a legitimate Machiavellian tool in an unruly world? The case of post-conflict Cambodia*, 35(5) *Third World Quarterly* 872, 878 (2014).

¹² Sokunthea Hout & Ramo Nuch, *The Roles of China's Aid to Cambodia's Socio-Economic Development*, (2016) *Selected CICP Publications* 1, 53–62

¹³ Interview in Kampong Speu, Cambodia, Oct. 30, 2019.

¹⁴ Hout & Nuch, *supra* note 12, at 8

¹⁵ Pheakdey Heng, *Hydropower and local community: A case study of the Kamchay dam, a China-funded hydropower project in Cambodia*, 48(3) *Community Development* 385, 399 (2017). For example, Kamchay Dam's construction has

blocked villagers' access to bamboo forests, land and water, which compromised the traditional livelihoods of bamboo collectors, fishermen and fruit sellers. Despite this, they are not compensated by the CPP or Sinohydro.

¹⁶ John Giorciari, *China and Cambodia: Patron and Client?*, IPC Working Paper Series 1/2013 (2013) 31 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2280003

¹⁷ Sun Narin & Kounila Keo, *Building on Chinese's bill*, PHNOM PENH POST, (Oct. 6, 2010), <https://www.phnompenhpost.com/lift/building-chinese-bill>

the views of the Cambodian public and it follows that there are two implications. Firstly, an alternative non-CPP government may not be as willing as the CPP to engage in corrupt deals. Thus, it will be difficult for SOEs to obtain the same degree of favourable treatment in hydropower contracts. Secondly, Cambodians are likely to support the political opposition in curbing Chinese investments that exploit Cambodia's legal institutions.

Prospects for Hydropower Investments

SOEs' hydropower investments are viewed negatively by non-CCP Cambodians as they rely on the acquiescence of the CPP's political elite, not least in bypassing legal institutions, for the long-term success of hydropower investments. In turn, their investments could be jeopardized if a non-CPP regime takes over Cambodia.

This situation raises the question: what is the probability that the CPP will lose power? Considering that Cambodia's main opposition party has been dissolved, the CPP will remain in power in the *short-term*.¹⁸ The CPP won all 125 parliamentary seats in the 2018 elections,¹⁹ as opposed to merely 68 out of 123 seats in the previous 2013 elections.²⁰ However, the CPP's political dominance is less predictable in the *long-term*. Considering that all hydropower dam projects are based on BOT contracts which last 30 to 50 years, it is impossible to predict whether the CPP will remain in power for the duration in which the Chinese SOEs operate the dams and receive investment returns.

¹⁸ *Hun Sen, Cambodia's ruler, has been in power too long*, THE ECONOMIST, (Mar. 22, 2018), <https://www.economist.com/asia/2018/03/22/hun-sen-cambodias-ruler-has-been-in-power-too-long>

¹⁹ O'Neill, *supra* note 9.

Recommendations

A long-term solution to safeguard the prospects of hydropower projects in Cambodia would be to deal with the popular distrust of such projects. Establishing amicable relations with the public and opposition parties would reduce the SOEs' reliance on the CPP's support in ensuring investment success. This solution is two-pronged. Firstly, Chinese SOEs should create and execute a corporate social responsibility-based framework that meets the immediate needs of locals,²¹ such as implementing proper compensation measures for loss of land, providing alternative employment opportunities for affected locals, and minimizing the environmental impact of the hydropower dams. Secondly, SOEs (supported by the Chinese state) should take direct steps to form friendly business relations with opposition politicians in Cambodia. Hence, if a non-CPP regime governs Cambodia, this regime will be more likely to protect the SOEs' hydropower investments. The long-term payment guarantees will then be enforced, regardless of the political party that governs Cambodia in the future.

Furthermore, to address Cambodia's popular discontent towards the hydropower projects' exploitation of Cambodia's rule of law, Cambodia may consider adopting some of the statutory and regulatory mechanisms that govern foreign investments in, for example, Singapore. Singapore has various measures relating to corporate governance, which compel Chinese SOEs to engage in investment activities with transparency

²⁰ Charlie Campbell, *Cambodia is a Deadly Political Mess That The World Completely Ignores*, TIME, (Feb. 28, 2014), <https://time.com/10442/cambodia-protests-marred-by-racism-violence-detentions/>

²¹ Vannarith Chheang, *The Political Economy of Chinese Investment in Cambodia*, 16 ISEAS Publishing 1, 26-27 (2017).

and legality. Also, the Singapore Exchange will suspend listed companies with serious financial and corporate governance issues. With these measures, Chinese SOEs investing in Singapore are held to a high standard of corporate conduct. Furthermore, for public sector construction projects, including hydropower projects, a rigorous assessment of the price and quality of bids would be done by the Singapore government during the tender process. This review acts as an indirect mechanism to screen Chinese SOEs that seek to invest in construction projects. Moreover,

Singapore strictly enforces its corruption laws, which prohibit the offer of any form of political advantage or favor to politicians or government officials. Thus, while Singapore would not screen foreign Chinese investments at the outset, there are robustly-enforced mechanisms supported by government authorities and financial institutions that continually monitor such investments.

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