CAMBODIA 2040

Volume 3

CAMBODIA 2040

INTERNATIONAL RELATIONS AND GOVERNANCE

Edited by

DETH SOK UDOM

BRADLEY J. MURG

OU VIRAK

MICHAEL RENFREW

Chapter 7 | Monetary Policy and Rielization

Rasheed J. Griffith and LOR Samnang

Vichet arrived in Cambodia for the first time in 20 years since migrating to the United States at a young age. It is now 2040 and he is amazed by the rapid and pronounced development of Cambodia since he left. He needs to find a mobile sim card in order to use the internet and make a call to his friend. The cost of a sim card is 20 Riel but he realizes that there is no Riel currency in his pocket. Therefore, he has to exchange from USD to Riel to buy a sim card. He then can use the internet and install Grab in order to go to the hotel. The transportation cost is 40 Riel as it appears on his phone's screen. He realized that he has to exchange all his USD to Khmer Riel for any transaction being made as it seems that business in Cambodia will only accept Riel for the sale of goods and services. Vichet asks the taxi driver to find him the currency exchange service along the way to the hotel where he can exchange his remaining USD currency to Khmer Riel. Stepping into the hotel late at night, he walks to the reception area and pays 150 Riel for three nights. The next morning Vichet calls his friend Kosal to discuss his purpose of coming to Cambodia. They go to Starbucks where it is convenient to talk about Vichet's business plan. Vichet and his friend talk about a potential project that entails an investment of about 800,000 Riel. Recognizing that the kingdom as a whole does its "mental financial math" in Riel, Vichet soon realizes that Rielization is real.

I. Monetary Policy in 2040: Ideal Scenario

As a result of institutional reforms led by the Royal Government of Cambodia (RGC) in the previous two decades, Cambodia has demonstrated a deep structural transformation in its approach to monetary policy. Cambodia achieved its goal of practical internal de-dollarization/Rielization which followed a wide adoption of the domestic currency by the population. Over 90% of commercial bank deposits and practically all circulating currency is denominated in Riel. Cambodians routinely use Riel in their daily transactions without being coerced or compelled.

In the urban centres retail payments are rarely done with physical money. Most of these transactions are done via smartphone e-wallets. With great success the monetary authority issues three versions of Riel: coins, polymer notes, and digital Riel. Cambodians can transfer money from their online bank accounts to their digital wallets as if they were making a cash withdrawal at an ATM.

Cambodians finally shifted to the Riel in droves after the government announced that they would transition the National Bank of Cambodia into an orthodox currency board arrangement (CBA) with the anchor currency as the U.S. Dollar; forgoing the pretence of an independent Central Bank. A currency board has a singular goal: to issue "notes and coins convertible on demand into a foreign anchor currency at a fixed rate of exchange" (Hanke 2002)11. These arrangements are not allotted any discretionary power to manipulate the money supply. This ensured absolute convertibility of the Riel and significantly reduced the risk expectations of the population. Cambodians saw this reform as a serious indication of the government's commitment to a credible Riel.

As a consequence of this commitment by the government to not interfere in the market mechanism of the currency, Cambodia has seen steadily increasing inflows of foreign direct investment (FDI). The government has been restricted from monetizing budget deficits which promotes the development of rigorous

[11] https://ieagh.org/wp-content/uploads/2014/11/steve-hanke-annals.pdf

measures to adjust fiscal performance. This included increasing the capacity to effectively fund itself from tax revenue.

Inflation has mirrored the economy of the anchor currency. As Cambodia has adopted an CBA the government no longer required a specific policy for inflation targeting since the majority of inflation is imported.

II. Scenario Space and Key Factors

Monetary policy cannot do what policy makers want to force it to do. Kith Sovannarith, Deputy Director of Banking Supervision of the NBC stated that "[the NBC] cannot directly use rates to increase jobs and investment" because of the high levels of dollarization12. Central Banks have long advocated for monetary policy to be used as a synthetic tool to fine-tune fiscal ends.

But this myth of fine-tuning merely conceals the reality of blind tinkering. Essentially, policy makers have surreptitiously shifted the burdens of fiscal policy to monetary policy - confounding the two. We can call this policy shift 'monetary fiscal-ladenness'. But when monetary policy is absolved of its fiscal-ladenness, its true - and sole role - is deceptively elementary: the management of the quantity of money. A stable and predictable money enables market price signals to remain unencumbered and long term financing contracts to retain their reliability.

It is this form of stability that promotes credibility in domestic markets and attracts foreign investment. The fiscal-ladenness of monetary policy obscures which institution is really responsible for developmental goals: the government. Sound monetary policy, then, solely focuses on monetary management. To update a metaphor deployed by Friedman (1968), money is like an operating system on which various software applications (economic activity) functions. Monetary policy is keeping the operating system well functioning and stable. Monetary policy should not be concerned with engineering apps (unemployment rates, capital growth rates, etc.).

---

[12]https://www.khmertimeskh.com/14404/cambodia-is-handicapped-by-dollarization/

In terms of the scenario space under discussion here, there are three key factors that led to this ideal scenario of monetary reform based on a concerted resistance of the fiscal-ladenness of monetary:

1. *Monetary credibility*: the monetary authority which issues the currency would have adopted a strict rule based policy architecture to absolve the risk of currency manipulation.
2. *Maintaining absolute convertibility*: Riels need to be convertible on demand, at any time, and in any amount, into the anchor currency.
3. *Strategic anchor selection*: the anchor currency must have strong international network effects, material capital market depths, and competence governance.

The role of each of these key factors is discussed in detail in the policy recommendations section.

Historical Development of Cambodian Monetary Policy

During the pillaging and torture of the haunting period of 1975-1979 the Khmer Rouge implemented the strictest variation of Communism recorded. Money and private property, in all forms, was banned by the Khmer Rouge. Cambodia is the only nation in modern history to have had its money totally abolished in an attempt to implement “true Communism” (Prasso 2001). This did not happen in the Soviety Union; it did not happen in Maoist China; and it did not happen in North Korea. Cambodians saw all of their Riel savings and stored wealth evaporate. And this memory lingers. After the Khmer Rouge regime was ejected from power in 1979, the National Bank of Cambodia (the Central Bank) was re-established in “as a sociolist institution designed to collect foreign exchange and pay State liabilities to foreign governments” (Ear 1997). But since the 1980s Cambodia has experienced successive miscarriages of monetary policy.

The Riel was re-introduced in 1980 with lackluster acceptance. Cambodians were asked to forget the economic trauma of the last few years and to trust the currency again. Of course this is easier said than done. Knowing that all of your life savings can disappear overnight is going to be a persistent paralysis in accepting the Riel again. The Central Bank knew the population would not quickly regain trust in the currency. The NBC was forced to anchor the new Riel in something the population actually trusted. During this post-regime period the population was mostly concerned with the very basics of life. Rice was one asset that everyone knew and wanted. The NBC decided to anchor the new Riel currency with cans of rice. Most people knew the uniform cans of milk that were imported from the Soviet Union. The Central Bank harnessed this familiarity to equate one new Riel to four milk cans worth of rice. (Khou 2012).[13]

To exacerbate the lapse of institutional credibility Cambodia was gutted by periods of high inflation. When the Union of Soviert Socialist Republics (USSR) eventually imploded Cambodia felt the shockwaves (Chandler 2008). Up until 1989 the USSR was Cambodia's largest aid donor and main trading partner (for what little trade was done by Cambodia at the time). And around this same period the Vietnam military began to withdraw from Cambodia leaving the country to finance its own military operations. Military spending was of great importance at this time given that the new government was still justifiably paranoid of a resurgence of the Khmer Rouge. The costs of military spending reached about 30% of the national budget in this period. With these concurrent shocks the government pillaged the Central Bank by monetizing the budget deficit (or in colloquial terms: printing money).

Accordingly, in 1990 the Riel money supply ballooned by 241%. And by 1992, inflation had reached nearly 200% (Im and Dabadie 2007). Yet again Cambodians rapidly lost their Riel savings and stored wealth. At this point Cambodia was allotted international assistance driven by the haphazardly organized and primarily US funded United Nations Transitional Authority in Cambodia (UNTAC): "its mandate was ambiguous, its time was limited, and most of its personnel knew nothing about Cambodia" (Chandler 2008). Nonetheless, with the rapid inflow of aid workers and the need to finance their own operations USD surged through the Cambodian economy. $2 Billion USD was brought in by the UN missions and other international development institutions.

[13]https://www.nbc.org.kh/download_files/research_papers/english/50367-The-Functionality-of-Monetary-Plurality-in-Cambodia.pdf

Dollarization has been a perennial feature of the Cambodian economy ever since. It is worth emphasizing unlike other scenarios of dollarization, the process occurred in Cambodia while the economy was effectively nonexistent; and noted by Samreth and Okuda (2019). This can account for the depth and persistence of dollarization in the country. From 1998-2018 Cambodia’s average annual GDP growth was approximately 7.9% while being highly dollarized (Saing 2020). This suggests that the dollarization of Cambodia could have enabled faster economic growth than what would have been otherwise. But it should be noted outright that dollars are not, and have never been, legal tender in Cambodia. Article 43 of the Law on the Organization and Conduct of the National Bank of Cambodia (1996) states that only Riel coins and notes are legal tender in Cambodia.

According to the official statistics from the NBC in May 2019 foreign currency make up 95% of total bank deposits.[14] The official statistics cannot account for the share of dollars in currency circulation as the NBC does not have a method to capture this information. But the IMF estimates the share of circulating dollars to be 90% as quoted by Hill and Menon (2013).

There is a chorus of experts within the Kingdom and within multilateral agencies including the ADB and IMF that contend that there are generally two problematic consequences of this kind of dollarization: loss of seigniorage and loss of an independent monetary policy. It is claimed that both are necessary for Cambodia to continue steadily along its development path. Ouk Maly, the Vice Governor of the National Bank of Cambodia (NBC) stated in 2018 that dollarization “increases costs and vulnerabilities to the Cambodia economy” as the size of the economy grows. And that dollarization “limits the effectiveness of [Cambodia’s] monetary policy].”[15]

Most recently, the NBC has launched Project Bakong which is essentially an initiative to create, issue, and market a digital clone of Riel. The goal of Project

[14]https://www.nbc.org.kh/download_files/publication/eco_mon_sta_eng/Review%20307-May-2019%20-Eng.pdf (p17)
[15] https://www.khmertimeskh.com/115086/de-dollarisation-needed-for-sustainable-growth-nbc/

Bakong is to promote the local use of Riel by "providing advantages to transactions in Riel over those in US dollar.16" It is hoped that Project Bakong will "encourage the use of local currency in the sense that it facilitates the payment of high value transactions instead of using US Dollar.17" That is, the NBC believes that by having a method to pay for high value assets via your mobile phone it be sufficient to persuade Cambodians to use less USD. This is based on the curious assumption that the fundamental reason for not using Riel is that it is cumbersome. But this assumption is not well justified. The NBC cannot simply digitize the Riel to bypass the core concern of the Riel's lack of credibility.

Credibility

As long as a Central Bank exists it is dependent on the commitment of the fiscal authorities to adhere to maintaining expenditures within their means. Without such a commitment there is no guarantee that the government will resist the allure of the "printing press" as has been the case in the 1990s.

Monetary credibility cannot be divorced from political credibility and wedded solely to legislative formalities. Even if that was sufficient, Cambodia is ranked 127 out of 128 countries on the World Justice Report Rule of Law Index 202018. Based on this index only Venezuela has a lower empirically recognized effectuality of rule of law.

Many policy makers in Cambodia, and Economists writing about Cambodia, have argued that since there has been an increase in political stability then there should have been an increase in the use of Riel (Im and Dabadie 2007; Menon 2008; Hill and Menon 2014).

But the market unambiguously disagrees. Cambodians simply have no desire to hold Riel in this life or the next. During Pchum Ben (Cambodia's festival of the dead) many Cambodians will burn offerings at the grave sites of their ancestors

[16] https://bakong.nbc.org.kh/download/NBC_BAKONG_White_Paper.pdf
[17] https://bakong.nbc.org.kh/download/NBC_BAKONG_White_Paper.pdf
[18] https://worldjusticeproject.org/rule-of-law-index/global/2020/Cambodia/

so they can use these gifts in the afterlife. These offerings range from foods to cardboard cars. But most importantly they burn fake USD bills so their ancestors can use it to buy goods. They do not burn fake Riel bills because they do not believe the Riels are of good enough value.[19] As Julia Wallace puts it, in Cambodia "even ghosts prefer dollars."

There is an institutional independence deficit within Cambodia and that is a key factor in considering the credibility of monetary policy. The Law on the Organization and Conduct of the NBC places the management of the NBC directly under a 7 member Board of Directors. But Article 12 requires that a member of the Board needs to be representative of the head of the Royal government. And Article 13 states that the Governor and Deputy Governor can be dismissed by Royal Decree on the recommendation of the Royal Government; effectively at-will of the Prime Minister.[20] Our main argument is not that the NBC required reform. But instead that the NBC should be separated from the issuance of the currency.

Convertibility

The fundamental philosophy of convertibility is another key factor in determining the future prospects for monetary policy (i.e the quantity of money in the economy). Convertibility is the ability of a holder of a clone currency to exchange the clone currency for an equivalent amount of the anchor currency. Monetary regimes are typically framed as the dichotomy of floating exchange on one side and fixed exchange on the other with "pegged" used interchangeably for "fixed." But the conflation of pegged and fixed regimes is a category error that obscures the dissimilarity of these systems. If we instead take the operational targets of monetary regimes as the basis for categorization

[19] https://www.nytimes.com/2016/04/09/world/asia/cambodia-qingming-festival-ghosts-prefer-dollars.html?fbclid=IwAR1xQMKzHnMAn9vdIwg_I9YyIw13xtPf8_OzRyrH9CFpsp20_1RIpNUiivw

[20] https://www.nbc.org.kh/download_files/legislation/laws_eng/96061-Law-on-the-Organization-and-Conduct-of-the-National-Bank-of-Cambodia-1996.pdf

we can see that floating and fixed exchange rates are uni-target regimes and a peg is a dual-target regime (Friedman 1972).

In a floating rate regime the Central Bank has a monetary policy but no exchange rate policy. That is, the base money is solely determined domestically by the Central bank and the exchange rate is on autopilot; come what may. In a fixed rate regime the monetary authority has an exchange rate policy but no monetary policy. That is, base money is determined by the net foreign reserves and the monetary policy is on autopilot; come what may.

There is a purgatory in between the two. If a monetary authority tries to target both an exchange rate and a monetary policy there will inevitably be a conflict between the dual targets, leading to balance of payment frictions. This can then devolve into a crisis similar to what occurred between 1997-1998 across Asia.

The NBC currently runs a managed float which, like a peg, targets both an exchange rate and monetary policy. A better policy that ensures long-term convertibility would require the adoption of either a clean float rate or a clean fixed rate. A clean float is exceedingly unwarranted as that would require the National Bank of Cambodia to not interfere in the economy. But as discussed above the NBC purposely wants to middle in the economy on the basis of the unjustified fiscal-ladenness of monetary policy.

The alternative would be a fixed rate regime. There are two methods of doing this:(i) full dollarization or (ii) a currency board. From a political lens full (official) dollarization may be untenable. But even if it was politically feasible it would still be a second best option to a currency board (Worrell 2003).

Currency Boards

A currency board affords the same benefits as dollarization in addition to some others. Under a currency board arrangement a clone currency (domestic currency) is fully anchored by a foreign currency. For example, Hong Kong has operated a generalized currency board with the USD since 1983. For every Hong Kong Dollar issued there is an equivalent amount of USD held by the Hong Kong

Monetary Authority: ready to redeem the HKD if anyone so desires.[21] HKD are as good as USD because HKD is a clone of USD. It is as if Hong Kong and the United States were in a currency union using the same currency with a different name.

It should be apparent then that dollarization and currency boards anchored by the dollar afford the same monetary stability benefit - effectively creating a currency union. And like in any currency union there is a single monetary policy throughout. If Cambodia adopted a currency board it would adopt the same monetary policy as the USA automatically through this transitive relationship. But if a currency board affords the same benefit why not just dollarize? There are two main reasons other than political incompatibility.

Firstly, unlike dollarization a currency board is also a fiscal barometer. In a dollarized economy there is no quick market-determined metric to assess the fiscal policies of the government. By retaining a domestic currency we can see on a day to day scale if people are converting out of the domestic currency at higher than usual rates. This is an unambiguous metric which assesses confidence in the fiscal performance of the government.

Secondly, a frequent objection to dollarization is the loss of seigniorage. Menon (2008), then Principal Economist at the Asian Development Bank, went so far as to attempt to argue that “the estimated seigniorage loss alone may well outweigh the benefits [of dollarization] flowing from greater price stability, reduced exchange rate volatility, and other forms of macro policy credibility.” This is an incurably inconsistent claim.

In Cambodia, seigniorage is estimated to be $61 million USD annually according to Kang (2005) which is also quoted by Menon (2008) while GDP in 2008 was around $10 billion USD. An open economy dependent on trade should not jettison macro policy stability in an attempt to gain a mere additional $61 million USD annually. It is quite curious as to why Menon (2008) thinks this trade-off is justified.

[21] https://www.bis.org/publ/bppdf/bispap73j.pdf

In 2017 Cambodia's trade-to-GDP ratio was 124.9% making it one of the most trade dependent nations. And if the macro policy loses credibility, leading to negative effects on trading positions and foreign investment the eventual annual loss would likely greatly exceed $61 million USD.

Moreover, with a currency board the anchor currency reserves are not solely held in cash in a vault. These reserves are split into two categories: short term liquidity and long term liquidity (Hanke 1993). The first category can include cash and instruments with short term maturities on which interest is paid. And then instruments in the second category would carry larger interest payments. Effectively, the currency board would earn money from the anchor reserve instruments which could equal the amount of money lost by foregoing seigniorage. In the current financial environment interest rates are low. But perpetually low interest rates are unlikely and they may rise again even in the near-future.

A further objection levied against a currency board for Cambodia is that it is "too costly" to establish as argued by (Menon 2008). But contrary to that argument, Cambodia has the financial capacity to initiate a currency board. To initiate the currency board Cambodia would only need enough international reserves to cover the monetary base outside banks (i.e. Riel in circulation). The monetary base is valued at $2.7 USD billion and current international reserves are valued at $14.5 USD billion.[22] The "too costly" objection is baseless.

III. Policy Initiatives Required to Achieve the Ideal Scenario

We propose that the Royal Government of Cambodia should create an orthodox currency board to issue Riel. In so doing the monetary policy situation of the ideal scenario would be realizable through these key factors: The key factors in pursuit of Cambodia's monetary policy reform are:

1. Monetary instrument rule credibility

[22] https://www.ceicdata.com/en/indicator/cambodia/money-supply-m1

2. Absolute convertibility of the currency
3. Stable market-determined growth rate

Absent any pronounced internationally acknowledged state liberalization within the country there are some limitations on what monetary arrangements can be prescribed. Monetary policy proposals that are best suited for jurisdiction with an advanced level of state-capacity like Norway are not necessarily transferable to Cambodia. But even with this assumption there is a package of policy prescriptions that can be adopted to advance a stable monetary policy and achieve sustainable Rielization. We recommend that the National Bank of Cambodia be exorcised of its ability to issue currency. Then an ultra-orthodox currency board arrangement (or, CBA) should be established. The level of “orthodoxy” is a function of how insulated the board is from the administrative instruments of the government. We propose a CBA which maintains a materially insulated management structure to project the maximum of confidence in the Cambodia population.

The following details should be considered:

1. The CBA should be incorporated in a jurisdiction other than Cambodia. This jurisdiction should have a high ranking on empirically sound indices of both rule of law and transparency. Singapore would be the recommend choice
2. The CBA should be headed by a Board of Directors of five (5) members.
3. The Chairman of the Board should not be a Cambodian citizen.
4. The other members of the board should comprise an American, a Singaporean, and two Cambodians without government positions.
5. All Board members must have sufficient professional expertise.
6. The CBA should be officially a private corporation.

On first blush this reform prescription may seem overly bold and subject to fatal criticism. But we have anticipated four potentially strong criticisms and will refute each in turn.

Firstly, the jurisdiction critique: why incorporate in Singapore if the currency board is to serve Cambodia? If the currency board is incorporated within Cambodia then it would be subject to government pressures both implicit and explicit. It could be said that the government is not likely to take over or influence the currency board because the government wants to ensure that the currency board maintains credibility. But even the risk of government influence is pervasive enough to convince the population that the currency board will not be credible. Therefore, to maximize credibility the Cambodian currency board must be incorporated outside the juridical reach of the government, as was done historically by other countries (Hanke 1995).

Secondly, the nationality critique: how could such an important national institution be headed by a person of another nationality? This is an effort to retain as much political neutrality as practically possible. After the signing of the Dayton Peace Agreement which ended the war in Bosnia and Herzegovina (B&H) the Central Bank was reincarnated as a currency board. It was decided that a national of New Zealand should become the initial Governor of the newly established B&H currency board. The fractured governments in the jurisdiction agreed that such a move would inculcate credibility by showing there are active measures to insulate the currency board from potential political manipulation (Coats 2007). Therefore, to maximize credibility the Cambodian currency board should be headed by a non-Cambodian.

Third, the nationality critique: why specify other nationalities and limit Cambodians to only two director positions? Is that not prejudice since it implies that Cambodians are not capable of being directors of the currency board? The aim of the board composition is to project credibility to the Cambodian population. As the board is incorporated in Singapore it is logical that one member should be a legal-financial professional from that jurisdiction. An American specifically selected for the purpose would likely be another neutral party. Of course there can be some justification that an American could be replaced with a Japanese or Australian or whichever nationality that is perceived as neutral. Those are plausible options as well. The board is limited to two Cambodians for the simple reason of insulating the board from political pressure and bias. It matters more how the Cambodian population perceives the insulation of the board over whatever semiotic argument of fairness can be levied. Therefore, to maximize credibility the Cambodian currency board arrangement's board of directors should be limited to only two eminently qualified Cambodians.

Fourth, the private incorporation critique: if an institution is issuing a national currency then how could it be a private corporation? Not only is there historical precedent for private corporations to issue a nation's currency but one of the world's more robust economies still has its national currency issued by private corporations. All of Hong Kong's currency (except coins and the ten dollar note) is issued by three fully private corporations: The Hongkong and Shanghai Banking Corporation Limited, the Standard Chartered Bank (Hong Kong), and the Bank of China (Hong Kong) Limited.[23]

What is required is that the banks transfer sufficient USD instruments to the Hong Kong Monetary Authority equivalent to the value of notes they issue. Again this is another measure that insulates the currency board from political manipulation. Therefore, to maximize credibility the Cambodian currency board should be a private corporation with a single transparent goal: issue currency and maintain at least 100% reserves of the anchor currency.

The discussion thus far is to clarify why and how to structure the issuance mechanism to ensure credibility. But another key elem ent is the appropriate section of the anchor currency.

The Anchor Currency

Cambodia's selection of the Khmer Riel anchor currency must be contextualized within an analysis of monetary geopolitics. It may seem like an obvious policy choice to choose the USD as the anchor currency for the Cambodian CBA. But there are decent challengers worth exploring: the Japanese Yen; the Chinese Renminbi (RMB); or a newly invented regional Asian Monetary Unit (AMU). We shall briefly analyze each in turn.

[23]https://www.hkma.gov.hk/media/eng/publication-and-research/reference-materials/monetary/Money_in_Hong_Kong_English.pdf

The Yen

Japan has sought to internationalize the Yen since the late 1980s. A significant proportion of Japanese multinational corporations (MNCs) operate in ASEAN countries. This means that these MNCs have to constantly monitor exchange volatility in the course of their general supply chain management. Hayakawa and Kimura (2009) show that trade with East Asia was more significantly affected by exchange rate volatility than other regional trading blocs. From a Japanese perspective, domestic (Japanese) MNCs would be better served with generalized intraregional exchange rate stability. This could be achieved if regional trading partners used Yen and the invoicing currency.

Further, the internal financial stability of ASEAN trading partners concerns Japan as it is vital for Japanese MNCs to operate within stable markets. A large scale financial crisis within a trading partner would have significant negative business effects on the Japanese MNCs according to Kawai (2014).

The Asian financial crisis of 1997 was the materialization of Japan's greatest fear as it related to intra regional financial market stability. It was Japan who most assisted the crisis hit Thailand by providing bilateral aid to help stabilize the financial market. The United States refrained from contributing bilateral aid to Thailand since the US Congress could not justify why they should provide aid to such a distant country. In fact the US only came to the table when the crisis spread to Mexico (Amyx, 2002).

Japan saw this reluctance on the part of the United States and IMF as proof that Japan needed to take the lead to set up a uniquely Asian monetary institution to assist in a time of crisis within Asia. And for good reason. Japan was at a greater risk than the United States and therefore had a deep interest in not only stopping contagion but also preventing it from happening again.

It can be argued that Cambodia would be served well in selecting the Yen as the anchor currency because in a time of crisis it would be easier to attain concessionary financing in Yen from Japan. Unlike the United States, Japan has a vested interest in ensuring that economies of ASEAN countries remain stable.

However, the bulk of Cambodia's trade is not with Japan. And therefore the invoicing currency will not be Yen. Given that Yen is not the invoicing currency of choice this adds unnecessary extra costs when doing cross-border trade if the Yen was the anchor currency.

The Renminbi

Trade volume is one basic criteria for determining the anchor currency. If the majority of Cambodia's trade is conducted with the United States then it would be a clear decision. But China is Cambodia's largest single trading partner. In 2017 Cambodia imported $5.3 billion from China but only exported $758 million to China.[24] Additionally, China is the single largest source of tourists to Cambodia and the top contributor of foreign investment. Although trade with China is so extensive, according to the NBC only $70 million worth of yuan was paid by Chinese firms to Cambodian firms in 2017.[25] In fact, USD is still the primarily used settlement currency in net trade for Cambodia. This is the case for the vast majority of world trade (Casas et. al. 2017).

It is also true that China has made meaningful strides in internationalizing the RMB in the last two decades and will steadily continue to do so in the next two decades. Progress, however, has been marginal against the dollar. Between 2010 and 2016 the RMB moved from being the 35th most used currency in global payments settlement to the 5th most used. This appears to be a significant jump. But in total volume terms even at 5th place RMB accounts for just 1.88% of global payments while the USD accounts for 43.09% (Park 2016). Similarly, in 2013 RMB became the second most used currency in global trade finance behind the USD. But even in second place at 8.66% of total volume in that market it exceedingly lags the USD which accounts for 81.08% of total global trade finance (Park 2016).

[24] https://www.khmertimeskh.com/544118/forum-sheds-light-on-rising-rmb-usage/
[25] Ibid.

While the RMB may seem like a challenger to the USD in the near future, very little evidence justifies that assertion. On the practical side Cambodians are already familiar with and have accepted USD as 'hard currency'.

The Asian Monetary Unit

But how hard will that currency be in 2040? With the recent policy decisions of the United States Federal Open Market Committee there is justified skepticism on the long term prospects of the USD as the global trade currency, in general, and as the invoicing currency of choice within ASEAN, in particular. As a response to the economic shock caused by the COVID-19 pandemic, the FOMC turned on the flow of new money from a trickle to a deluge. So much so that 40% of the Fed balance sheet was added only in the first half of 2020 alone. This makes the argument of a significant USD crisis and crash not unlikely. If in the year 2000 an Economist said that the US Fed would perform such an operation, he would be ridiculed and laughed out of every university lecture hall. And yet here we are. So looking at the next 20 years it is not heretical to claim that Dollar hegemony would have ended.

This may spur renewed calls for an Asian Monetary Unit (AMU). This would be based on a basket of currencies significantly weighted in favor of the larger economies within the bloc. But this raises several institutional challenges that may be untenable. China and Japan are the largest economies in the bloc and would have to significantly work together to decide on the characteristics and management of the new currency unit. This may be a non-starter political problem as international relations between these two states continue to deteriorate.

Shanghai is trying to position itself as the global financial centre while Tokyo is trying to reposition itself there as well. And the prospect of quality monetary governance cooperation is already strained given that the two countries could not even agree on the path forward on development financing leading China to create the Asian Infrastructure Investment Bank (AIIB) in 2013 in a bid to compete with the Japanese led Asian Development Bank (ADB).

But suppose the new AMU is formed without China or Japan. Is this a path forward or in reality is it the worse of all possible worlds? Let's continue with the assumption that the USD is no longer the currency of choice for cross-border trade within ASEAN and East Asia. Cambodia performs relatively little trade with other ASEAN countries. China is Cambodia's largest trading partner and will likely continue to trend in that direction. Cambodia would have to convince China to invoice its goods in the AMU for it to make sense for Cambodia to use the AMU as its anchor currency. But of course this is practically impossible. In a post-Dollar world Chinese firms will price its goods in RMB. And if the goods are priced in RMB why go through the unnecessary costs of currency conversion, foreign reserve management, and potential balance of payment frictions? It would make sense to just adopt RMB as the anchor currency for khmer riel is this case.

If an AMU is formed without China but with Japan, can that be stable? Although Japan has significant political clout in ASEAN this orientation is also unlikely to be workable. China is the largest trading partner of the majority of ASEAN states. There is very little benefit of adopting a new currency that still needs to be exchanged for RMB. Further, this also requires bets to be made on the growth of Tokyo relative to Shanghai. Given Tokyo's stagnant economy, the financial markets of Shanghai may yet become more attractive. This means that more monetary instruments would be priced in RMB.

Which to choose?

The above discussion is a contemplation of a world without USD hegemony. But based on the current structure of the monetary world it still makes the most sense for Cambodia to adopt the USD as the anchor currency. The dollar market is still the most capital deep, most trusted, and most used. The network effect of the USD is structurally significant and worth treating as a going concern for the time being.

By following the aforementioned policy recommendations we suggest that sustainable Rielization can be realized in Cambodia. Once trust is injected into the Riel and Cambodians see that it is a credible currency with absolute convertibility then the utilization of the US dollar will fade and eventually become trivial.

IV. Baseline Scenario: Business as Usual in 2040

The institutional arrangement of the National Bank of Cambodia does not inspire confidence. A frequently used slogan in NBC rhetoric is that over the last decade Cambodia's economy has grown while retaining a stable exchange rate as a consequence of the steady hand of the NBC. But in more frank terms, Cambodia has grown while being heavily dollarized. This point has also been raised elsewhere: "the contribution of monetary policy to this [socio-economic improvement] appears unlikely given the limited monetary capacity of the National Bank of Cambodia and the high level of dollarization…" (Saing 2020). It would require a counterfactual judgement to determine what would be the realistic economic position if there was no dollarization.

Retaining the status quo will inevitably lead to a persistent neglect of Riel by the population. Since the early 1990s central bankers have been trying to regain an independent monetary policy in order to accelerate economic growth. Within The Financial Sector Development Strategies issued by the Royal Government of Cambodia, emphasis has been consistently given to methods of promoting the Riel without force.[26] But that changed this year. In May 2020, the NBC announced that it will pass on the costs to commercial banks for exporting small USD notes ($1, $2, and $5). Currently the NBC is the only institution allowed to coordinate the exporting of worn out USD notes to international banking partners to exchange them for newer notes. In effect, the NBC has increased the transaction costs of small USD notes relative to Riel notes.

While there are reasonable arguments for phasing out small USD notes some financial institutions are already preparing for the possibility of the NBC

[26]https://www.nbc.org.kh/download_files/publication/blueprints_eng/Financial-Sector-Development-Strategy-2016-2025-English.pdf

announcing it will no longer transport $10 notes.[27] This policy should be rightly seen as the beginning of forced de-dollarization. And herein lies the danger.

Perhaps, the main impetus for de-dollarization is the gaining of an independent monetary policy. But with more careful consideration of the status quo an independent monetary policy will likely plunge the economy again into an inflation spiral; as has happened in the past. Not out of malice or incompetence on the part of the NBC but because of fiscal pressure.

Institutionalization of the rule of law remains a very serious challenge, which means that there can be no political credibility to any rule based monetary policy. If there is no rule based monetary policy then discretionary policy would be the default. As discussed above, monetary credibility is inextricably linked to political credibility. The status quo sucks away any hope of actual or perceived monetary credibility of the Riel.

If fundamental de-dollarization is achieved (even if done surreptitiously as in the case of the small notes cost transfer) then there is a material risk of losing out on foreign investment. The currency risk would be too disadvantageous for investors to risk their capital being evaporated by the mismanagement of the domestic currency.

Under current conditions, the kumbaya of monetary independence within Cambodia is merely a kabuki theatre. The risk of currency mismanagement prevents foreign lenders from giving as favorable terms in long term contracts. This would increase borrowing costs and limit the amount of lenders willing to do business with the domestic market. There is little benefit that can arise from following this path.

Moreover, since the Riel will not be seen as unencumbered from political interference, a bet on Riel markets would at the same time be a bet on the avoidance of such interference. At present, large swaths of investment in the kingdom are done despite the kingdom's relatively low scores across multiple metrics of risk, corruption, and rule of law - the currency is explicitly separable.

[27] https://www.khmertimeskh.com/50770277/nbc-yet-to-issue-small-banknote-fee/

But with Riel as the sole currency these two spheres will be conflated. And in this situation there is likely going to be a reduction of investment as a result.

Without dollarization and without monetary credibility it is impossible to defend a stance of supposed monetary independence - even if it was desirable. Accordingly, we are forced to conclude that business as usual policies will lead the Riel to the slaughter bench of history.

References

"Cambodia Money Supply M1 [1995 - 2019] [Data & Charts]." [1995 - 2019] [Data & Charts], 1 July 2019, www.ceicdata.com/en/indicator/cambodia/money-supply-m1.

"Cambodia Is 'Handicapped' by Dollarization." Khmer Times, 12 Mar. 2017, www.khmertimeskh.com/14404/cambodia-is-handicapped-by-dollarization/.

Casas, Camila, et al. "Dominant Currency Paradigm: A New Model for Small Open Economies." IMF Working Papers, vol. 17, no. 264, 2017, p. 1., doi:10.5089/9781484330173.001.

Chandler, David P. A History of Cambodia. Westview Press, 2008.

Coats, Warren. One Currency for Bosnia: Creating the Central Bank of Bosnia and Herzegovina. Jameson Books, 2007.

Cock, Andrew Robert. "External Actors and the Relative Autonomy of the Ruling Elite in Post-UNTAC Cambodia." Journal of Southeast Asian Studies, vol. 41, no. 2, 2010, pp. 241–265., doi:10.1017/s0022463410000044.

"De-Dollarisation Needed for Sustainable Growth: NBC." Khmer Times, 20 Mar. 2018, www.khmertimeskh.com/115086/de-dollarisation-needed-for-sustainable-growth-nbc/.

Eijffinger, Sylvester, and Eric Schaling. "The Ultimate Determinants of Central Bank Independence." Positive Political Economy: Theory and Evidence, pp. 47–74., doi:10.1017/cbo9780511559662.007.

"Forum Sheds Light on Rising RMB Usage." Khmer Times, 25 Oct. 2018, www.khmertimeskh.com/544118/forum-sheds-light-on-rising-rmb-usage/.

Friedman, Milton. The Role of Monetary Policy. American Economic Review Vol. 58, No.1, 1968.

Friedman, Milton. Have Monetary Policies Failed? American Economic Review Vol. 62, No. 2, 1972

Hanke, Steve H., and Kurt Schuler. Alternative Monetary Regimes for Jamaica. Private Sector Organisation of Jamaica, 1995.

Hanke, Steve H., et al. Russian Currency and Finance: a Currency Board Approach to Reform. Routledge, 1993.

Hanke, Steve H., and Nicholas Krus. "World Hyperinflations." Routledge Handbook of Major Events in Economic History, doi:10.4324/9780203067871.ch30.

Prasad, Eswar. Gaining Currency: the Rise of the Renminbi. Oxford University Press, 2017.

SAMRETH Sovannroeun, OKUDA Hidenobu, Economic Growth and Dollarization in Cambodia, アジア研究, 2019, 65 巻, 1 号, p. 61-78, 公開日 2019/03/27, Online ISSN 2188-2444, Print ISSN 0044-9237, https://doi.org/10.11479/asianstudies.65.1_61, https://www.jstage.jst.go.jp/article/asianstudies/65/1/65_61/_article/-char/ja, 抄録:

Saing, Chan Hang. Monetary Policy in Small Open and Dollarized Economy: An Experience of Cambodia. South East Asian Central Banks (SEACEN) Research and Training Center, 2020.

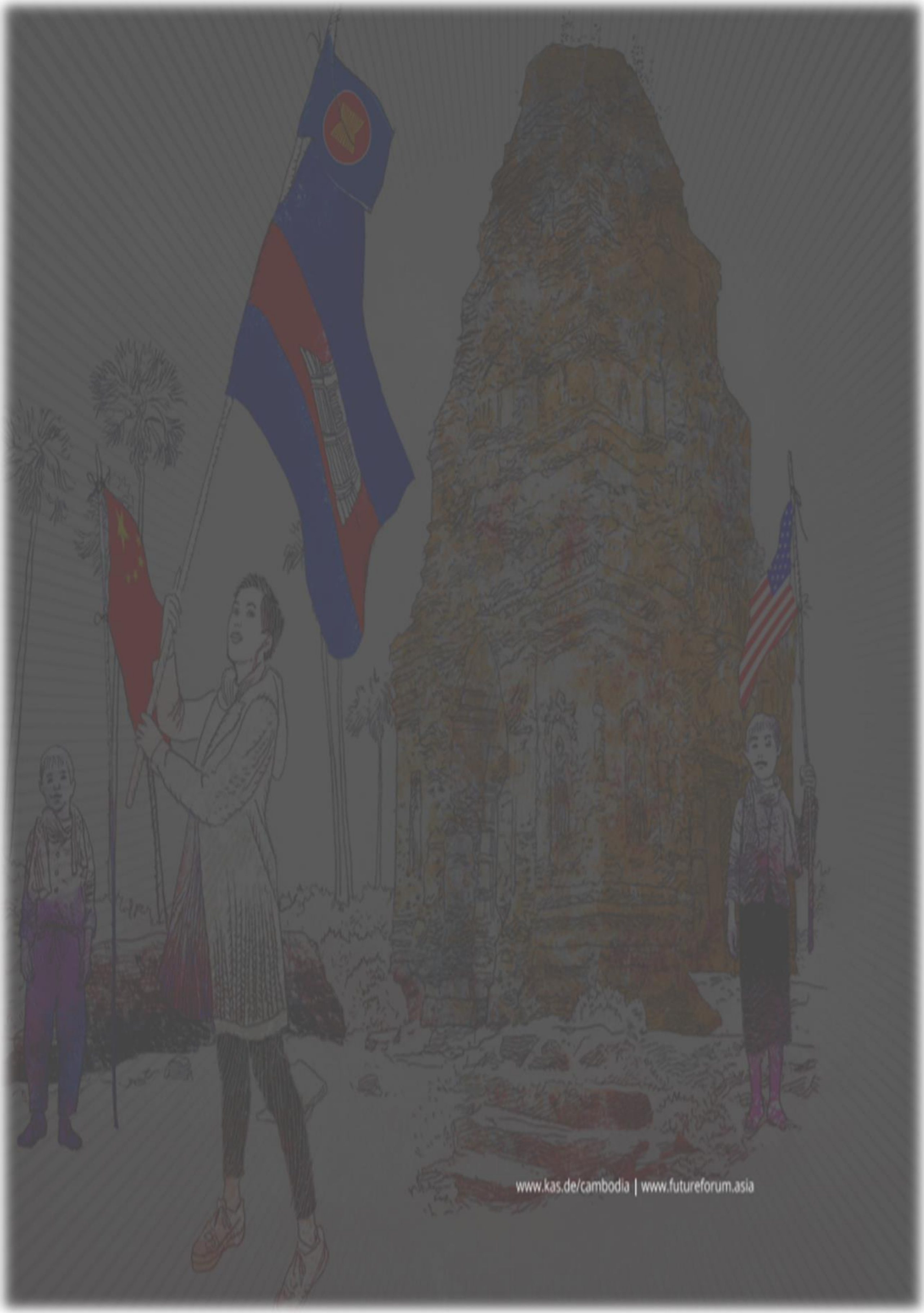
Prasso, Sheridan, The Riel Value Of Money: How The World's Only Attempt To Abolish Money Has Hindered Cambodia's Economic Development. Analysis from the East-West Center. No. 49, 2001.

Wallace, Julia. "In Cambodia, the Ghosts Prefer Dollars." The New York Times, The New York Times, 8 Apr. 2016, www.nytimes.com/2016/04/09/world/asia/cambodia-qingming-festival-ghosts-prefer-dollars.html?fbclid=IwAR1xQMKzHnMAn9vdIwg_I9YyIw13xtPf8_OzRyrH9CFpsp20_1RIpNUiivw.

White, Lawrence H. Free Banking. Edward Elgar, 1993.

Worrell, Delisle. "Economic Policies in Small Open Economies." Economic Paper, 1993, doi:10.14217/9781848594982-en.

Worrell, Delisle. "Monetary and Fiscal Coordination in Small Open Economies." IMF Working Papers, vol. 00, no. 56, 2000, p. 1., doi:10.5089/9781451847697.001.


www.kas.de/cambodia | www.futureforum.asia