

# Chapter 7

## Development Strategy for CLMV in the Age of Economic Integration

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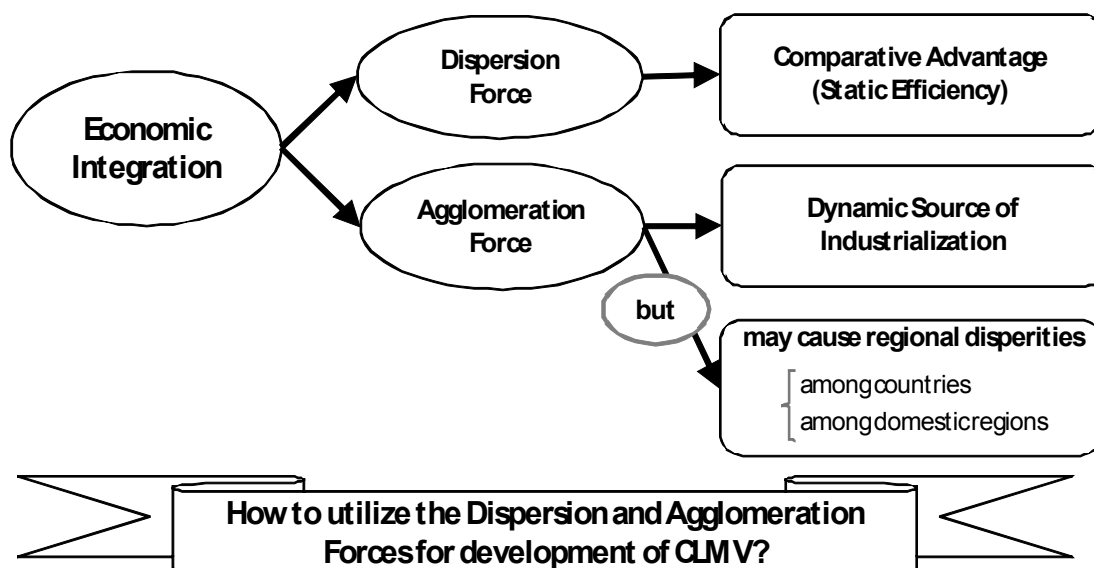
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## 7. DEVELOPMENT STRATEGY FOR CLMV IN THE AGE OF ECONOMIC INTEGRATION

Huge development gaps still remain in East Asia, as can be observed by the more than hundredfold disparity in GDP per capita (Figure 2-3). We must squarely face up to this challenging reality. At the same time, however, when proper policy environments are provided, this disparity can be turned into a source of economic dynamism for the region through effective utilization of globalizing forces. In other words, the disparity itself can be the driving force to narrow development gaps. This claim is strongly supported by the development experiences of forerunning ASEAN countries.

**Figure 7-1: Development strategy for CLMV in the age of economic integration**



In view of increasingly intensifying global competition, the development strategy of each country should be designed to effectively utilize dispersion and agglomeration forces in production and distribution networking (Figure 7-1). Along the development path, the key issues will start from how to participate in networks, and shift to how to formulate industrial agglomeration, and then how to upgrade industrial structure. Therefore, necessary policy measures differ by country, according to country-specific

conditions such as the phase of economic development, factor endowments, and location.

In order to intensively investigate the development strategies tailored for the latecomers in ASEAN, namely Cambodia, Lao PDR, Myanmar, and Vietnam (CLMV), an ERIA research project entitled “*Development Strategy for CLMV in the Age of Economic Integration*” has been conducted. This chapter summarizes the main findings and policy recommendations.

### **7.1. Narrowing development gaps**

Regional economic integration has been rapidly progressing in East Asia, with increasing numbers of FTAs and EPAs. Liberalization of international trade and investment accompanying the process of integration is expected to accelerate economic growth of the whole region. At the same time, however, there remain persistent concerns that economic integration may also expand the existing development gaps among individual member countries, as well as among domestic regions in each country. If such regional development gaps continue to expand, it could hamper the progress of regional integration in the East Asia.

Though the new members of ASEAN, CLMV, share many similar circumstances, the group also has many differences, e.g. market size, economic priority, etc. For example, while Vietnam has achieved high levels of economic development, per capita income and industrialization, the rest of the group still shares low income and limited human resources.

CLMV share common characteristics, such that they are transition economies, there is prevailing high poverty incidence, their economies are agro-based and there are weak institutions to support market economies. Although CLMV countries have enjoyed a certain degree of macroeconomic stability in recent years and are considered as some of the fastest-growing economies in the region, unemployment and under-employment still persistently exist. The CLMV countries still face huge challenges in fighting poverty and narrowing gaps in wealth among their populations, as well as development gaps among regions, especially rural and urban areas, within their countries.

Though there are some different constraints in the process of development by

individual country, CLMV have vast potential for future development. The development of CLMV has to be depending on individual country effort and support from development partners in and outside the region.

ASEAN is strongly committed to regional integration with a special emphasis on narrowing the development gap among its members. Within this context, the Initiative for ASEAN Integration (IAI) Work Plan for Narrowing the Development Gap within ASEAN was adopted to assist new member Countries with the aim of narrowing the development gaps among ASEAN member countries and expediting greater regional economic integration, promoting equitable economic development and helping to alleviate poverty in CLMV.

Narrowing development gap is consistent with ASEAN's commitment to build an economic community. A fully integrated ASEAN will sustain its relevance, enhance its competitiveness in the face of the increasing challenges of globalization and regionalization, and will serve as a catalyst for strengthening East Asian economic integration. Moreover, an economically strong ASEAN will not only benefit ASEAN alone, but also its partners. Therefore, the integration of ASEAN remains a critical factor which will be of significant benefits to East Asia as a whole.

## **7.2. Challenges ahead of CLMV and the role of regional partners**

This project aims to frame the development strategies for CLMV in the age of globalization and to help narrow development gaps among countries in the region. The focuses are based on the assessment of economic performance, economic reform programs, challenges and policy recommendations for CLMV as a group, for individual countries, and for external partners to achieve substantial development of CLMV economies.

### *7.2.1. Cambodia*

Since Cambodia achieved peace and national reconciliation through the 1991 Paris Accord and 1993 General Election, Cambodia has enjoyed a broad degree of macroeconomic stability and development. Though starting from a very low base, Cambodia is considered one of the fastest-growing economies in the region, with double-digit growth rates and macro-economic stability for the past five years.

However, many development challenges persist, including a high poverty rate, a big income gap, a low production base and poor human resources. The main sectors that contribute to economic growth are the garment industry, tourism, construction and agriculture. The country is implementing the 3rd Five Year Plan, the National Strategic Development Plan (NSDP; 2006-2010), to implement the Government's Triangular Strategy, which focuses on growth, employment, equity and efficiency. Cambodian has very few finished products, and they are usually of such poor quality that they cannot compete with similar products imported from neighboring countries. Human resource development and promotion of trade and investment are very crucial for future development (Chap, 2008a).

#### *7.2.2. Lao PDR*

Within the context of regional economic integration, Lao PDR has been facing numerous challenges as the country being one of the least developed countries (LDCs) in the world. Hence, the Lao government has called for a long-term socioeconomic development strategy with the goal to graduate from the status of LDC by the year 2020. To achieve this goal, the Lao government has made great efforts to build a relatively comprehensive development strategy framework, which includes the Industrialization and Modernization Strategy, the Sixth National Development Plan (2006-2010), the National Growth and Poverty Eradication Strategy (NGPES) and sectoral long-term development strategies. However, to implement the government's development strategy framework based on the country's specific potential and opportunities successfully to narrow the country's development gap within the region, some policy recommendations to be emphasized from a research perspective might be taken into account, namely; (1) infrastructure development with a focus on land-linked countries and economic corridors; (2) strengthening the private sector by promoting SMEs and developing markets, namely, financial, labour, and real estate markets; (3) developing the tourism industry by promoting cultural, eco-based, and historical tourism in the country as a sustainable tourist friendly destination; (4) natural resource based industry both as environmental friendly and economic efficiently industry; (5) promoting processing industries in the country for export and domestic consumption; and (6) human resource development with a focus on vocational schools and training for skilled labour.

### 7.2.3. Myanmar

Myanmar has a vast potential for future economic development due to a big local market, abundant natural resources and a young labor force, all of which have not yet been fully tapped. Though Myanmar is facing many challenges in dealing with domestic and international problems, the country is committed to integrating its economy into the region. The four economic objectives (Basic Economic Guidelines towards Democratic State) are: (1) development of agriculture as the base and all-round development of other sectors of the economy as well; (2) proper evolution of the market-oriented system; (3) development of the economy by inviting participation in terms of technical know-how and investments from sources inside the country and abroad; and (4) the initiative to shape national economy must be kept in the hands of the state and the national peoples. Accelerating economic reforms, especially financial reforms, and re-aligning exchange rates, promoting SMEs, Special Economic Zones and taking advantage of its geographical location between China, India and ASEAN will promote Myanmar's economic development (Kan Zaw, 2008).

### 7.2.4. Vietnam

Vietnam has good conditions to progress in reforming itself. The process of economic reform initiated since 1986, with an important view to pro-actively engaging in international economic integration, has brought about important socio-economic achievements, and laid more concrete foundations for future economic development in the country. Yet, the country still faces many challenges in further reforming itself, which makes realizing its development goals a challenging task. Vietnam has set some ambitious basic development objectives for the years to come: (1) to sustain high economic growth; (2) to escape the status of a poor country by 2010 (there is a high possibility that the objective will be realized in 2008); (3) to accelerate industrialization and modernization process so that by 2020, the country will basically become "a modern-oriented industrialized country"; and (4) to make the slogan "Prosperous people, a forceful country, and an equitable, democratic and civilized society" a reality.

The main policy recommendations are (1) to promote country's comparative advantages moving up along the value chain by: (i) diversifying/differentiating export products and strengthening non-price competitiveness; (ii) attracting efficient FDI; and (iii) improving labor and management skills; (2) to accelerate SOE reform, with the

focus on the large SOEs, by means of securitization and listing on the stock market; (3) to establish better prerequisites for development of the financial market, especially the corporate bond market; build up an effective financial supervision system and appropriate capital account liberalization; and (4) to deepen the tax reforms, especially those associated with the taxation administration and assets tax, to broaden the tax base (Vo, 2008a).

#### *7.2.5. Thailand*

As a close neighbor, Thailand plays a very important role in economic cooperation with CLMV. Thailand's famous policy, "prospering its neighbors," has been started since early 1990s. To determine the importance of trade on economic development, we calculated the trade to GDP ratios for Thailand and CLMV (Chaisrisawatsuk, 2008). The higher the trade to GDP ratio, the more important trade is to the economy. The volume of international trade has been increasing not only for Thailand but also its neighboring countries. With Thailand leading the pack, the role of international trade in improving per capita income has been significant, especially in Cambodia and Vietnam. Trade between Thailand and its neighbors has also increased over the last decade. Thailand should help CLMV with capacity building, especially to improve human capital and productivity and encourage participation from private sector; to synchronize domestic rural development plan with international cooperative development programs; to build economic networking in the region to achieve the goal of narrowing development gap. Logistics networking can be a starting point of further networking so that the region will be developed into a single hub.

#### *7.2.6. ASEAN*

There is no doubt that the integration gap, also a development gap, is an important concern because the level of ASEAN integration achieved at the end of the day will decide whether the regional grouping will be able to face increasingly stiff globalizing economic headwinds. However, given the possibility that the development gap within the three-tiered grouping may widen further because benefits arising out of globalization may become even more unevenly distributed among the disparate members of the grouping, the integration gap could be considered not as critical as the previously mentioned three development gaps, viz. infrastructure gap, income gap, and

institutional gap. After all, the quantum of trade between ASEAN-6 and the CLMV countries remains trivial, and integration does not seem to be actually that important a concern for ASEAN, as suggested by its actions when it devised new rules to accommodate members' requests for delays in the inclusion of certain products in the coverage of AFTA. And since the integration gap could be considered not as critical as the infrastructure gap, income gap, and institutional gap, the IAI Work Plan could thus divert some resources away from projects that presently come under the area of "Regional Economic Integration."

#### *7.2.7. China, Japan and Korea*

China, Japan and Korea are the most important partners to help develop CLMV to the next level of development. Increasing amounts of trade and investment from these countries will help promote CLMV economies through the promotion of technology transfer, skills enhancement, job creation, capital mobilization and infrastructure improvement. Official Development Assistance (ODA) from these countries is still vital for CLMV to build the foundations of economic development and help in implementing reform programs. To promote cooperation between CLMV and China, Japan and Korea, CLMV countries should provide competent workers, produce quality products and adopt open door policies to attract FDI from these countries. China, Japan and Korea should continue to support the development of economic and social infrastructure that is in great demand in CLMV countries, and provide assistance to reduce trade imbalances as well. To implement region-wide development efficiently and effectively, it is essential to conduct studies related to the benefits/costs of region-wide development brought by training and capacity building as well as by mechanisms supporting cross-border economic transactions (Hao, 2008; Uchida and Kudo, 2008; and Cheong, 2008).

### **7.3. Policy recommendations**

Policy recommendations derived from this project are expected to provide a basic direction for the development strategies of CLMV countries. However, the specific policy measures are to be determined by each government, according to country-specific conditions. For example, the individual paths of the industry



upgrading should be chosen to reflect the resource endowment and other socioeconomic conditions in each country. Similarly, the most desirable process for development cooperation between CLMV and other East Asian countries also depends on the current status of the international relations. Therefore, country-specific and relation-specific conditions for individual problems should also be taken into consideration.

The following are three policy recommendations that can be regarded as the most urgent and relevant for CLMV as a whole<sup>12</sup>.

### *7.3.1. The development and utilization of special economic zones in CLMV*

The CLMV economies have not been deeply integrated into the East Asian production and distribution networks in spite of their various location advantages, notably abundant, reasonably well-educated and low-waged labor forces. Underdeveloped infrastructure, logistics in particular, and poor investment climates hinder them from participating in such networks in East Asia. Service link costs and other business costs in CLMV have not become low enough to realize total costs reduction.

Special Economic Zones (SEZs) including Export Processing Zones (EPZs) could be a good policy tool to reduce the business and transaction costs that are embedded in the CLMV economies. SEZs will provide well-developed infrastructure with intensive capital investments in the demarcated production sites. SEZs will also provide efficient administrative procedures, including one-stop services for export and import, business services such as offshore banking and logistics, and governmental support for human resource development and technological transfer. All these efficient services will be made possible in SEZs by insulating them from the rest of the country, where investment climate is generally poor.

SEZs can be located along border areas, since border industry can offer a solution how to overcome high business and service-link costs in the CLMV economies. SEZs located in the border areas can connect to the regional and global economy through their borders with neighboring countries, Thailand in particular, which have logistic hubs such as deep seaports, airports, and trunk roads. Thus, firms, including multi-national companies (MNCs) located in the border areas of CLMV, can enjoy location advantages

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<sup>12</sup> For more policy recommendations, including country-specific ones, refer to Chap (2008a).

such as wage differences, while realizing total cost reduction with lower service link costs. Therefore, CLMV should develop SEZs in the locations with close linkages to transportation hubs. To develop SEZs, each country should provide a favorable legal framework, master plans, infrastructure, land clearance support, after-care services and close links between owners and potential investors, especially leading firms.

### *7.3.2. Transport network (hub) development*

The CLMV countries are endowed with excellent potential of geographic advantage: they face both the Pacific and Indian Oceans and are also adjacent to remarkably growing Asian countries such as China, India and Thailand. In order to fully exploit this geographical advantage, they need to develop a good logistics network that links major cities and ports in the above countries and CLMV. In fact, some parts of the network have been already constructed by the Greater Mekong Subregion (GMS) program, which is an ADB initiative. The main routes of these economic corridors should be extended and connected with each other by several branch links. In this process, the current schemes of public-private-partnership (PPP) should be improved, so as to promote efficient development and operation of the infrastructures. Moreover, to facilitate trade along these highways, “the ASEAN Framework Agreement on the Facilitation of Goods in Transit” should be continuously implemented.

It should be noted, however, that trade facilitation through construction of transport infrastructure is not enough to attract industrial firms to CLMV and help the countries achieve a vigorous economic growth. On the contrary, the good connections could encourage relocation of industries to clusters in the surrounding countries. In order to effectively utilize the constructed infrastructure for development of the CLMV economies, the governments need to launch some specific policy measures for attracting industrial firms to the sites within CLMV.

One of the most feasible measures is to develop transport hubs in the region. It is well known that a process of reciprocal reinforcement generally works between hub formation and agglomeration development.

A transport hub attracts firms, and this encourages the transport services around the hub, which makes the hub more attractive. In order to initiate these circular causations, it is important to encourage firms that heavily use the transport infrastructures. Note that these firms (transport users) do not necessarily exhibit scale economies nor the

tendency to agglomerate. The CLMV countries can start with fostering conventional industries, such as food, garment, resource-based manufacturing and tourism. When they have successfully attained the critical amount of transport demand to create a hub, they may upgrade the industries to those with more scale economies, e.g. chemical, machinery and electronics.

### *7.3.3. Human resource development: Vocational training and public administration*

The immediate and urgent need for human resource development (HRD) is central to the objective of capacity building in CLMV countries. Specifically, HRD must be implemented based on cost-benefit analysis in which the benefit is optimized and the cost is minimized. Investment in vocational training and public administration will supply the much-needed technical and vocational skilled workers. Upgraded and efficient public administrators facilitate the implementation of domestic reforms and institution building.

Often, developing countries spend their scarce resources and accord high priority to academic-oriented education. However, the tangible benefits of higher education in the form of academic-oriented universities are far less than establishing vocational training, especially in the area of practical technical education.

Another critical element of HRD is the training of public administrators, as they are critically in short supply in all developing countries. Public administrators are the key to the success of domestic reforms and institutional building in CLMV. Notwithstanding a plethora of trade and investment liberalization measures, the critical bottleneck is in the implementation, as there is a severe shortage of trained and capable civil servants and public administrators to implement policy and institutional reform.

It is both urgent and imperative to establish a functioning network of civil-service institutes in East Asia, to which CLMV can send their public administrators for training. In this respect, the Civil Service Institute (CSI) in Singapore has been notable in providing civil service training to ASEAN public administrators. In addition, Singapore and Malaysia have established a close collaboration in civil service training.