Executive Summary

DEVELOPMENT STRATEGY FOR CLMV IN THE AGE OF ECONOMIC INTEGRATION

Chap Sotharith

1. INTENTIONS AND AIMS OF THE STUDY

Regional economic integration has been rapidly progressing in East Asia with increasing numbers of Free Trade Agreements (FTAs) and Economic Partnership Agreements (EPAs). The liberalization of international trade and investment accompanying the integration process is expected to accelerate economic growth in the whole region. At the same time, however, there is concern that integration may also widen development gaps among individual member countries and among the regions in each country. If these regional development gaps continue to widen, they could hamper the progress of regional integration in East Asia. It is essential to study how extensively the gap-expanding force works in the integrated economy.

This research aims to frame the development strategies for Cambodia, Lao People's Democratic Republic or Lao PDR, Myanmar, and Vietnam (CLMV) in the age of globalization and help narrow the development gaps among countries in the region. It highlights the assessment of economic performance, economic reform programmes, challenges and policy recommendations for CLMV as a group, for individual countries, and for external partners in order to bring about substantial development of CLMV economies.

The recommendations derived from the study are expected to provide the basic direction for the economic development of CLMV,. but the individual policy measures should be determined by each government according to country-specific conditions. For example, the individual paths for the upgrading of industries should be chosen based on the resource endowment of, and other socioeconomic conditions in, each country. Similarly, the most appropriate form of development cooperation between CLMV and other East Asian countries should also depend on the current state of international relations between CLMV and their East Asian neighbors. The authors, therefore, tried to analyze development issues in the context of country-specific and relations-specific conditions for individual problems.

2. METHODOLOGY

The authors used qualitative analyses as the primary methodology. They reviewed economic performance, challenges, and prospects for CLMV and proposed policy recommendations based on statistical data and information from secondary sources, including published books, reports, and papers.

The report has 13 chapters in all. Chapters 1 and 2 provide a perspective on practical and theoretical issues in East Asia's integration while chapters 3 to 9 highlight the regional partners that will assist CLMV in narrowing development gaps. Chapters 10 to 13 focus on country-by-country analyses.

3. FINDINGS AND CONCLUSIONS

CLMV, which are relatively new members of the Association of Southeast Asian

Nations (ASEAN), share a number of similarities, although they differ in the size of their markets and economic priorities, among other things. While Vietnam, for example, has achieved high levels of economic development, per capita income, and industrialization, the other members of the group still have low per capita income and limited human resources.

CLMV's similarities include their primarily agro-based, transition economies, high poverty incidence rate, insufficient infrastructure, and institutions that are still too weak for a shift to a market economy. Although CLMV have enjoyed a certain degree of macroeconomic stability in recent years and are considered one of the fastest-growing economies in the region, unemployment and underemployment still persist. CLMV are still facing huge challenges in fighting poverty, narrowing gaps in wealth among the population, and addressing development gaps within the regions.

Although each country in CLMV faces different development constraints, CLMV as a whole has a huge potential for future development, which will depend on individual country efforts and support from development partners within and outside the region.

The ASEAN is strongly committed to regional integration with 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 the ASEAN was adopted to assist new member countries reduce development gaps among themselves and expedite regional economic integration, promote equitable economic development, and help alleviate poverty in CLMV.

The aim of narrowing the development gap is consistent with the ASEAN's commitment to build an economic community. A fully integrated ASEAN will sustain its relevance, boost its competitiveness in the face of the increasing challenges of globalization and regionalization, and be a catalyst for strengthening East Asia integration. Moreover, an economically strong ASEAN will benefit both the member countries and their trading partners. The integration of the ASEAN, therefore, remains a critical factor which will be of significant benefit to East Asia as a whole.

The specific findings in each country paper are discussed below:

3.1 Cambodia

Since Cambodia achieved peace and national reconciliation through the 1991 Paris Accord and the 1993 general elections, it has enjoyed a broad degree of macroeconomic stability and development. Though it started from a very low base, Cambodia is now considered as one of the fastest-growing economies in the region, enjoying double-digit growth rates and macroeconomic stability for the past five years. However, it still grapples with development challenges such as a high poverty rate, large income gap, low production base, and inadequate human resources.

The main sectors that contribute to Cambodia's economic growth are the garments industry, tourism, construction, and agriculture. Cambodia exports mainly finished products, which are usually of poor quality. This makes it difficult for Cambodia to compete with its neighbours in terms of exports.

The country is implementing its third five-year plan called the National Strategic Development Plan (NSDP) for 2006 to 2010, the main goal of which is to set into motion the government's Triangular Strategy focusing on growth, employment, equity, and efficiency. Human resource development and promotion of trade and investment are very crucial for future development.

3.2 Lao PDR

Lao PDR is aiming to remove itself from the list of least developed countries (LDC) by 2020 and eradicate mass poverty by 2010. However, to achieve those goals, it must first deal with a number of constraints such as a low production base, lack of highly skilled human resources, poor infrastructure, and an unfavorable geographical position as a landlocked country.

The government hopes that infrastructure development, tourism development, and promotion of natural resources-based industries will change the country from being a landlocked one to a “land-linked”one. It is also hoped that this will provide Lao PDR full access to the seaports of neighbouring countries and other regional networks of roads and railways. These priority sectors are expected to significantly enhance the process of economic development and poverty reduction.

3.3 Myanmar

Myanmar’s huge and untapped potential for future economic development lies in its large local market, abundant natural resources, and young labor force. Although the country is dealing with a number of challenging domestic and international problems, it is committed to regional economic integration.

Myanmar’s four economic objectives (Basic Economic Guidelines towards Democratic State) are the following: 1) to develop agriculture as the base of the economy along with the other sectors; 2) to allow the a market-oriented system to evolve properly; 3) to spur economic development with the technical assistance and investment of local and foreign partners; and 4) to maintain the initiative to shape the national economy in the hands of the state and the people of Myanmar.

Myanmar's economic development will also be boosted by accelerating economic reforms, especially financial reforms, and realigning exchange rates; promoting small and medium enterprises (SMEs) and special economic zones (SEZs); and taking advantage of Myanmar's geographical location between China, India, and the ASEAN.

3.4 Vietnam

Vietnam began its economic reform process in 1986 with a view to proactively engaging in international economic integration. Due to its early headstart, it is now in a relatively good place in its reform process. It has, in fact, achieved important socioeconomic gains and laid a more concrete foundation for future economic development. However, it still faces many reform challenges, which makes realizing its development goals a formidable task.

Vietnam's basic development objectives are: 1) to sustain high economic growth; 2) to escape the status of a poor country by 2010 although it is highly likely that this objective will be realized by 2008; 3) to accelerate the industrialization and modernization process in order to become "a modern, industrialized country" by 2020; and 4) to transform into reality the slogan "prosperous people; a forceful country; and an equitable, democratic, and civilized society."

The main policy recommendations are 1) to promote Vietnam's comparative advantages and moving up along the value chain by: (i) diversifying/differentiating export products and strengthening nonprice competitiveness; (ii) attracting efficient foreign direct investments (FDIs); and (iii) improving labor and management skills; 2) to accelerate the reform of state-owned enterprises (SOEs) with emphasis on large corporations and their equitization and listing in the stock market; 3) to lay down better prerequisites for the development of the financial market, especially the corporate bond market and to build up an effective financial supervision system and appropriate capital account liberalization; and 4) to deepen tax reforms, especially those associated with the taxation administration and assets tax in order to broaden the tax base.

3.5 Thailand

As CLMV's neighbor, Thailand plays a very important role in strengthening economic cooperation. Thailand has a policy of "prospering its neighbors," which it launched in the early 1990s.

To determine the importance of trade with Thailand on the economic development of CLMV, the ratio of trade to Gross Domestic Product (GDP) for Thailand and CLMV were calculated. The higher the ratio between trade to GDP, the greater the importance of trade between CLMV and Thailand is to the economies of CLMV. On the whole, the volume of international trade has been increasing for both Thailand and its neighboring countries, especially within the last decade.

The role of international trade in improving per capita income has been significant especially in Cambodia and Vietnam. Thailand has taken the lead and should continue helping CLMV in capacity building, especially to improve productivity and encourage participation from the private sector. Likewise, it should help CLMV synchronize domestic rural development plans with international cooperative development programs and build economic networks in the region to achieve the goal of narrowing development gaps. Logistic networking can be a starting point to further networking so that the region can be developed into a single hub.

3.6 ASEAN

There is no doubt that the integration gap, which is 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. There is, however, 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 different members of the grouping. In view of this, the integration gap should not be considered as critical as the previously mentioned three development gaps, *viz*. infrastructure gap, income gap, and institutional gap. After all, the volume of trade between ASEAN-6 and CLMV 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 the ASEAN Free Trade Agreement (AFTA). And since the integration gap should not be considered as critical as the infrastructure gap, income gap, and institutional gap, the IAI Work Plan should thus divert resources away from projects that presently come under the area of "Regional Economic Integration."

3.7 China, Japan, and Korea

China, Japan and Korea are the most important partners to help bring CLMV to the next level of development. The increasing volume of trade and investment from these countries will help strengthen CLMV's economy through technology transfer, skill enhancement, job creation, capital mobilization, and infrastructure improvement.

Official Development Assistance (ODA) from these countries is still vital for

CLMV to build the foundation for economic development and to implement reform programs. To promote cooperation between CLMV and China, Japan, and Korea, CLMV should provide competent workers, produce quality products, and implement an open door policy to attract FDIs from these countries. In turn, China, Japan, and Korea should continue to develop economic and social infrastructure needed in CLMV and provide assistance to reduce trade imbalance.

To implement regionwide development efficiently and effectively, it is essential to conduct studies related to the benefits wrought by regionwide development such as training and capacity building and mechanisms supporting cross-border economic transactions.

4. POLICY RECOMMENDATIONS

The policy recommendations are divided into three groups: 1) common policy agendas for CLMV; (2) country-specific policy agendas for CLMV; and 3) policy agendas for development partners. Only the top three policy recommendations are highlighted in this summary.

4.1 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 and notably abundant, reasonably well-educated, and low-waged labor force. CLMV's underdeveloped infrastructure, logistics in particular, and poor investment climate hinder them from participating in such networks in East Asia. The cost of service links and doing business in CLMV are not yet at the point where players can realize total cost reduction.

Special economic zones (SEZs), including export processing zones (EPZs), could be a good policy tool to reduce business and transaction costs embedded in CLMV economies. SEZs can provide well-developed infrastructure with intensive capital investments in the demarcated production sites. SEZs can also provide efficient administrative procedures, including one-stop services for export and import, business services such as offshore banking and logistics, and government support for human resources development and technology transfer. SEZs will be able to provide these services efficiently if they are insulated from the rest of the country where investment climate is generally poor.

SEZs can be located along border areas where it will be easier for them to connect to the regional and global economy through the borders they share with their neighboring countries. Thailand, in particular, has logistic hubs such as deep-sea ports, airports, and trunk roads. Firms, including multinational companies (MNCs), located in the border areas of CLMV can enjoy location advantages such as wage differences while realizing total cost reduction with lower service-link costs. CLMV should therefore develop SEZs in locations closely linked to transportation hubs. To develop SEZs, individual countries should provide a favorable legal framework, master plans, infrastructure, land-clearance support, aftercare services, and a close link between owners and potential investors, leading firms in particular.

4.2 Transport Network (Hub) Development

CLMV have an excellent geographical advantage—they face both the Pacific and Indian Oceans and are adjacent to fast-growing Asian countries such as China, India, and Thailand. To fully exploit this geographical advantage, they need to develop a good logistic network that links major cities and ports in the abovementioned countries and CLMV.

Some parts of the network, in fact, have been already constructed by the Greater Mekong Sub-region (GMS) program on the initiative of the Asian Development Bank (ADB). Those economic corridors need to be extended and connected with one other by several branch links. In the process of doing this, the current schemes of public-private-partnership (PPP) should be improved to promote the 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 with construction of transport infrastructure is not enough to attract industrial firms to CLMV and achieve strong economic growth. On the contrary, the good connection could encourage relocation of industries to the clusters in the surrounding countries. In order to utilize the constructed infrastructures effectively for development of the CLMV economies, the governments of CLMV need to launch some specific policy measures for attracting industrial firms to the these sites.

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 development of 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 firms of transport users do not necessarily exhibit economies of scale or the tendency to agglomerate. We can start with fostering conventional industries, such as food, garments, resource-based manufacturing, and tourism industries. When we have successfully attained the critical amount of transport demand to create a hub, we may upgrade the industries to those with greater economies of scale like chemicals, machinery, and electronics.

4.3 Human Resource Development with the Emphasis on Vocational Training and Public Administration

Central to the objective of capacity building in CLMV is the immediate and urgent need for human resource development (HRD). 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 much-needed technical and vocational skilled workers. Trained and efficient public administrators facilitate the implementation of domestic reforms and institution building.

Often, developing countries spend their scarce resources and prioritize spending large amounts for “academic-oriented education.” However, there seems to be more benefits to establishing institutions for vocational training, especially for practical technical education, rather than “academic-oriented universities.”

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 institution building in CLMV. The severe shortage of trained and capable civil servants and public administrators to implement policy and institutional reform can create critical bottlenecks in the implementation process despite the plethora of trade and investment liberalization measures,.

To achieve this objective, it is urgent and imperative to establish a functioning civil-service institute exchange in East Asia where CLMV can send their public administrators for training in selected East Asian countries. 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.

Chapter 1

GROWTH AND GAPS IN EAST ASIA: TRADE, INVESTMENT, AND ECONOMIC INTEGRATION

Hank Lim

ABSTRACT

Economic integration in East Asia is picking up speed, due to foreign direct investments (FDI). This integration is increasingly based on production networking of agglomeration and fragmentation by optimizing the process of globalization.

However, there are visible evidences of constraints such as income gap, development gap, and institution gap. Globalization has relatively widened further the gap between the more-developed and the less-developed countries in the region. This has resulted in an uneven economic integration in East Asia.

There are a number of bilateral and subregional economic and technical assistance schemes for Cambodia, Lao People's Democratic Republic or Lao PDR, Myanmar, and Viet Nam (CLMV), but the scope and substance of such schemes are inadequate. It is considered as necessary, therefore, to develop policy packages and incentives in order to utilize globalizing and regional production network. There is, in fact, a clear sign that economic agglomeration is starting to influence industrial location, whereby CLMV could benefit from such process. The geographical proximity of China, India, Thailand, and Viet Nam as growth centres are definitely an advantage, as long as CLMV can reduce setup cost and service link cost. In turn, reducing such costs will require a gradual but vast improvement in infrastructure, institutions, human resource development, and governance of CLMV.

Toward this objective, it is suggested that multilateral stakeholder fund is put in place through policy recommendations and further commitment to increase and coordinate intra-ASEAN Official Development Assistance (ODA) is established. These will have to support infrastructure development, human resource development, and domestic policy reform. In the end, reducing development gaps will go a long way in improving ASEAN economic competitiveness and in moving towards a common production base and single market as embodied in the ASEAN Economic Community.

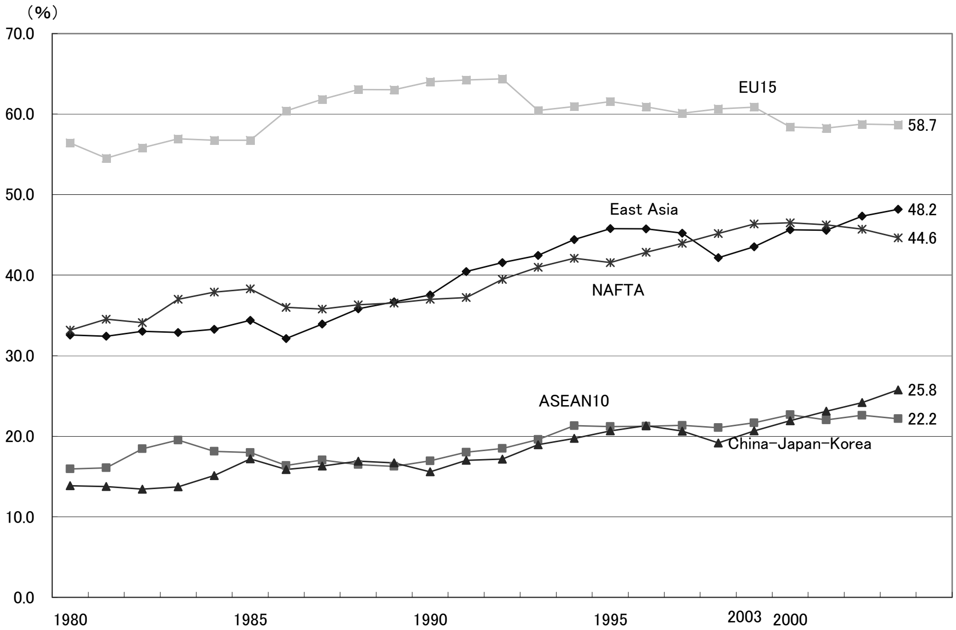
1. INTRODUCTION

Prior to the Asian financial crisis in 1997, rapid and dynamic economic growth in East Asia was facilitated through market-driven forces. Various regional economic cooperation initiatives and schemes were introduced, including and agreement on ASEAN Free Trade Area (AFTA) in 1992, which came into full operation by end of 2003.

The impact of ASEAN-initiated regional cooperation was negligible, because ASEAN economies were basically competing on the same product range and their main export markets were non-ASEAN countries. However, a clear evidence has been recently identified, which indicates that the impact of AFTA has encouraged production networking on some intermediate and consumer goods in Thailand, Viet Nam, and other ASEAN economies.

Some economists claimed that de facto economic integration has proceeded in East Asia, even as there was no effective implementation of AFTA and other regional bilateral trade and investment agreements. The nature and characteristics of de facto economic integration are crucially important in policy discussion to understand how far integration has been realized and what sort of integration has been achieved so far. Understanding such fundamental issues would be helpful for policymakers in designing regional and bilateral Free Trade Areas (FTAs) that will facilitate and accelerate further regional production networks. The development of vertical production networks have certainly been supported by trade liberalization efforts. On the other hand, the trade regime in East Asia is still far from a single production base and a single market. Substantial barriers in service trade still remain in East Asia. The development of vertical production networks and the remaining

Figure 1. Intraregional Trade (Exports and Imports) Ratio (percent)



Source: IMF, Direction of Trade, 2004 CD-ROM.

trade barriers affect the nature of ongoing process of de jure economic integration in East Asia.

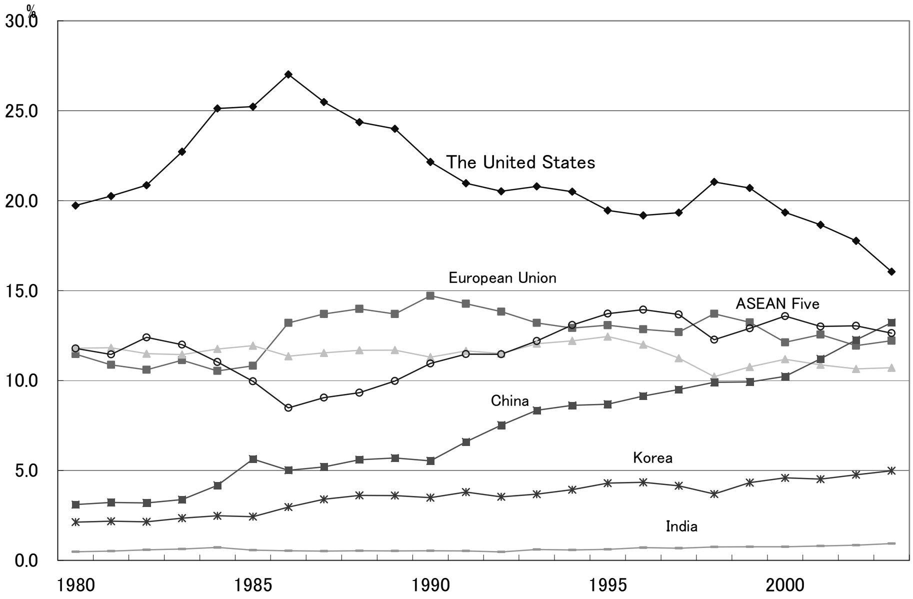
Since the early 1990s, international production networks have been developed in the ASEAN and surrounding East Asian countries. Production networking and regional division of labour have been pursued, resulting in massive vertical intra-industry trade in parts and components within the region.

International trade statistics clearly presents the recent advancement of de facto economic integration in East Asia. In Figure 1, which shows the share of intraregional trade (exports and imports) within several economic areas, the share of intra-East Asia trade remarkably rose from 34.9 percent in 1980 to 52.4 percent in 2003 (East Asia comprises the ASEAN 10, China, Japan, Hong Kong, and the Republic of Korea). Surprisingly, this increase is higher than that of NAFTA (44.6 percent) though a bit lower than that of the EU (58.7 percent). East Asia has no doubt achieved a high level of de facto economic integration in terms of international trade transactions within the region. The integration process has not been seriously interrupted even in the late 1990s when the Asian currency crisis happened.

However, economic integration in East Asia does not seem to develop in an even manner. The share of intraregional trade of the ASEAN 10 and China–Japan–Korea in 2003 remained at only 22.2 percent and 25.8 percent, respectively, as compared to that of East Asia (52.4 percent). This suggests then that economic activity requires a large space for expansion, that is, the whole East Asia, as the spatial economists would argue. Moreover, China and the ASEAN 5 (Indonesia, Malaysia, the Philippines, Singapore, and Thailand) increased their shares in East Asian trade, as shown in Figure 2. This suggests that even countries with relatively low-income levels have played a significant role in the expansion of the intraregional trade in East Asia.

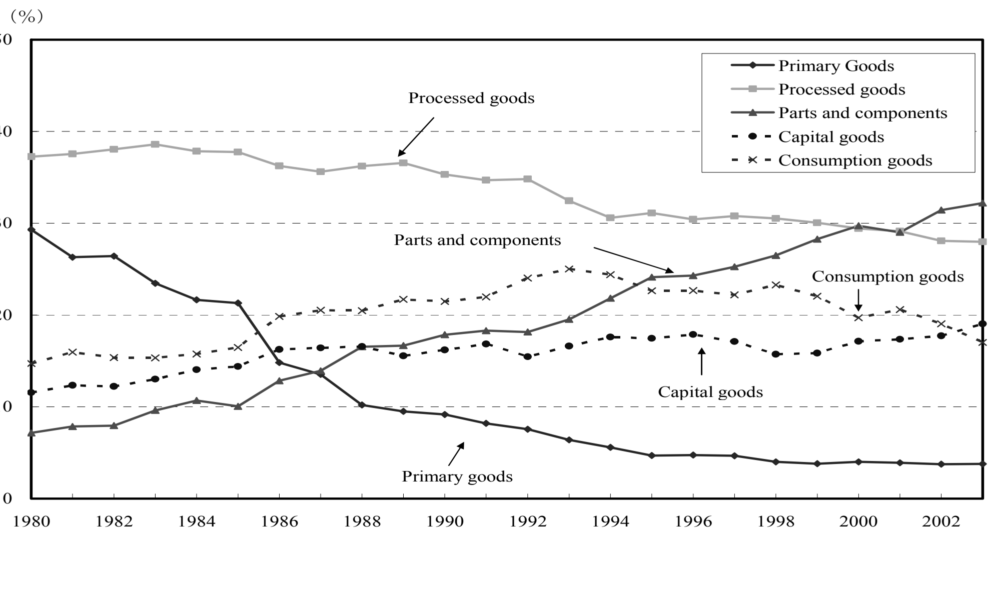
It should be noted that the trade pattern inside East Asia has changed, from the traditional pattern (in which final products, such as consumer goods, intermediate goods, and capital goods, were being traded) to a pattern where parts and components were traded. To put it differently, intermediate goods in the same industry have been actively traded among the Asian countries, expanding intra-industry and intraregional trades. For instance, import shares of parts and components within East Asia increased from 7.2 percent in 1980 to 32.2 percent in 2003, while those of processed goods decreased from 37.3 percent in 1980 to 28.0 percent in 2003. The shares of parts and components became the largest among commodity groups (see Figure 3).

Figure 2. Trade Share of East Asia with Partner Country (percent)



Note: East Asia consists of ASEAN 10, China, Japan, Hong Kong, South Korea, and Taiwan.
Source: IMF, Direction of Trade, 2004

Figure 3 Trade Pattern Inside East Asia (percent)



Source: ComTrade

From this development we can generate an observation about an explosive increase in East Asian trade in intermediate goods, particularly in machinery industries, based on production process-wise international division of labour among countries with different income levels and development stages. Trade patterns in today's global competitive climate where economies of scale strongly work are quite different from the traditional ones that are based on static comparative advantage. The whole production processes involve sequential production blocks located across countries. Different stages of production are shared by different suppliers located in different countries. Instead of final products, companies in different countries traded components and intermediate input.

This phenomenon is known as cross-border production sharing or fragmentation of production. Production processes, located in different countries in East Asia, are finely divided into many stages. It is theoretically confirmed that, in such vertical specialization, a slight decline in trade costs induces large trade in intermediate goods, since goods may move across national borders multiple times. For example, an intermediate good is exported from country A to country B and is imported back to country A again after being processed in country B. In this case, the good crosses a national border four times. This is what actually happens in East Asia—when trade costs decline, such decline comes with substantial increase in the competitiveness of the whole East Asia.

In the ASEAN and surrounding East Asian countries, international trade in parts and components has been expanded, and the international division of labour in terms of production processes has grown to an unprecedented degree. At the same time, economic agglomeration or industrial clusters have grown in several notable places where dense vertical supply chains are formulated. The fragmentation of production processes and the formation of economic agglomeration, however, are rather new phenomena that started in the late 1980s or the early 1990s. To understand the mechanism of agglomeration and fragmentation, understanding the new economic geography and the fragmentation theory would be useful.

The new economic geography explains the formation of economic agglomeration in geographical space. The spatial structure of economic activities is considered to be the outcome of a process involving two opposing types of forces, that is, agglomeration forces and dispersion forces.

The theoretical formulation analyzes the balance of these two opposing forces, which generate a variety of location patterns of economic activities. A key property of agglomeration forces resides in the circular causality of economic activities. For example, an automobile assembler would attract a number of upstream suppliers, and the resulting productivity enhancement and market expansion may in turn attract another assembler. Such circular causality would generate a sort of economies of scale in a geographical sense.

On the other hand, the growth of economic agglomeration would enhance dispersion forces at the same time. Concentration of economic activities would increase land prices and wage rates, bring tough price competition among firms, and cause traffic congestion, and air pollution. Due to such negative effects, dispersion forces would be intensified.

One of the important factors that delicately affect the balance between agglomeration forces and dispersion forces is the broadly defined transportation costs, which includes freight cost, tariffs, nontariff barriers, and risk for exchange-rate variation. As transport costs decrease, agglomeration may grow. With a further decrease in transport costs, production activity may rather disperse. The new economic geography analyzes factors, some of them are policy variables, that determine industry location among countries or cities in different sizes.

The fragmentation theory focuses on the location of production processes. Production processes are fragmented into multiple slices and located in different areas, say, in different countries in East Asia. Suppose that an electronics company originally has a huge factory in a developed country, and this factory takes care of the whole production processes, from upstream to downstream. If the company can separate production processes and establish them in appropriate places, the total production cost may be maximized.

There are three elements that make fragmentation possible. First, there must be production cost savings in fragmented production blocks; the company must take advantage of the differences in location between the original position and the new position. Second, the cost of service links that connect remotely located production blocks (that is, costs of transportation, telecommunications, and various types of coordination) must not be too high. Third, the cost of network setups is small. When additional cost for setting a new plant is relatively small, the production process can be easily fragmented.

The feasibility of fragmentation, therefore, heavily depends on the nature of technologies in the industry and the economic environment. New economic geography and the fragmentation theory provide insights into important factors that determine the location of economic activities in the globalization era.

2. POLICY ENVIRONMENTS THAT ENABLE UTILIZTION OF GLOBALIZING FORCES

International production or distribution networks in the ASEAN and surrounding East Asian countries are relatively the most advanced and sophisticated in the world. East Asia has no doubt developed a favorable policy environment suitable for globalizing corporate activities. However, such policy environment has been realized through accumulated profit-motivation actions by the private sector, rather than being developed with well-designed strategic moves. Analytical evaluation of policy environments that enable countries to take advantage of globalizing forces for economic development is necessary and important.

The new economic geography and the fragmentation theory provide rich implication for policy environments in the globalizing era. The new economic geography suggests policies affecting the agglomeration forces and the dispersion forces. The fragmentation theory lists up policies affecting production cost savings, service link cost, and network setup cost.

Combining the new economic geography, with careful consideration on policy needs that are possibly have different development stages, it is possible to develop desirable policy packages in order to utilize globalizing forces.

2.1 The Economic Development of Latecomers

The economic development of latecomers, in particular CLMV, is a very important agendum not only for CLMV but also for the ASEAN and the whole East Asian countries. The relationship between two objectives—to deepen integration and narrow development gaps—takes the most extreme form in this context.

2.2.1 Macroeconomic Indicators

In Table 1, which shows wide gaps in terms of GDP per capita between the ASEAN member-countries, Brunei and Singapore topped the list in 2006. On the other hand, CLMV, with GDP per capita of less than US$1,000, took the bottom of the list. Note that even among the older ASEAN-6 member-countries, there are wide gaps, with Indonesia and the Philippines trailing behind.

Cambodia, Lao PDR, and Myanmar are primarily agro-based, while Viet Nam has relatively large manufacturing and services sectors. Viet Nam's share of services in GDP was already on par with that of Indonesia's and Brunei's, while Singapore took the lead on the list. This explains that for economic integration to proceed smoothly, the issue of incompatible economic structures needs to be tackled.

Table 1: ASEAN Macroeconomic Indicatiors

	GDP at current prices (US$ '000 mil)		GDP per capita at current prices (US$ '000 mil)		Share of Agriculture in GDP		Share of Industry in GDP		Share of Services in GDP	
	2001	2006	2001	2006	2000	2004	2000	2004	2000	2004
Brunei	4.2	11.6	12.1	30.2	1.6	2.1	59.5	58.4	38.9	39.5
Indonesia	164.8	364.3	0.8	1.6	15.6	15.0	45.9	44.5	38.5	40.5
Malaysia	88.0	156.9	3.7	5.9	8.4	7.9	44.2	42.4	47.4	49.7
Philippines	72.0	117.5	0.9	1.4	19.9	19.7	34.7	33.0	45.4	47.3
Singapore	85.9	132.3	21.0	29.5	0.1	0.1	33.8	32.6	66.1	67.3
Thailand	115.6	206.6	1.8	3.2	10.3	9.3	44.4	46.7	45.3	44.0
Cambodia	3.8	7.3	0.3	0.5	39.6	32.8	23.3	30.7	37.1	36.5
Laos	1.7	3.5	0.3	0.6	52.1	50.2	22.7	24.6	25.2	25.1
Myanmar	8.3	12.0	0.2	0.2	42.9	42.9	17.3	17.3	39.7	39.7
Vietnam	32.6	61.0	0.4	0.7	23.3	20.2	35.4	39.4	41.3	40.4

Source: *ASEAN Statistical Yearbook* (various issues)
ASEAN Statistical Pocketbook 2006.

2.2.2 Human Development Index (HDI)

Average achievements in basic human development can be measured and compared using the human development index (HDI). Based on three component sub-indices (life expectancy, education, and GDP), the HDI value of a country, which ranges from 0 to 1, shows the distance the country has to travel to reach the maximum possible value of 1.

Table 2 compares the development states of the ASEAN member countries. The latest HDI rankings ("UNDP: Human Development Report 2006") put Singapore, Brunei, and Malaysia in the "high human development category," while the rest fall under the "medium human development" category.

Table 2: ASEAN Human Development Indicators

	Human Development Index (Rank)		Human Development Index (Value)		Life Expectancy Index		Education Index		GDP Index	
	1999	2004	1999	2004	1999	2004	1999	2004	1999	2004
Singapore	26	25	0.876	0.916	0.87	0.90	0.87	0.91	0.89	0.94
Brunei	32	34	0.857	0.871	0.85	0.86	0.86	0.88	0.87	0.88
Malaysia	56	61	0.774	0.805	0.79	0.81	0.80	0.84	0.74	0.77
Thailand	66	74	0.757	0.748	0.75	0.75	0.84	0.86	0.69	0.73
Philippines	70	84	0.749	0.763	0.73	0.76	0.91	0.89	0.61	0.64
Indonesia	102	108	0.677	0.711	0.68	0.70	0.79	0.83	0.56	0.60
Vietnam	101	109	0.682	0.709	0.71	0.76	0.84	0.81	0.49	0.55
Cambodia	121	129	0.541	0.583	0.52	0.52	0.66	0.69	0.44	0.53
Myanmar	118	130	0.551	0.581	0.52	0.59	0.75	0.76	0.39	0.39
Laos	131	133	0.476	0.553	0.47	0.50	0.51	0.66	0.45	0.50

Source: *UNDP. Human Development Report* - 2001 & 2006.

As if this is not bad enough, those falling within the “medium human development” category can be further subdivided into “upper,” “medium,” and “lower.” Note that Lao PDR was in the “low human development” category in 1999 but is now within the “medium human development” category in the latest rankings.

Table 3 shows the HDI trends of the ASEAN countries from 1985 to 2004. Though there have been improvements in HDI readings for all ASEAN countries, it is not likely that improvements expected to be achieved over the next 10 years or so by the less-developed ASEAN countries will be enough to enable them to catch up with the more-developed countries, because these countries will also be moving forward.

Table 3: Human Development Index Trends

HDI RANK (2004)	Country	HDI Values				
		1985	1990	1995	2000	2004
25	Singapore	0.786	0.823	0.862	…	0.916
34	Brunei	…	…	…	…	0.871
61	Malaysia	0.696	0.723	0.761	0.791	0.805
74	Thailand	0.680	0.717	0.751	0.775	0.784
84	Philippines	0.695	0.722	0.738	0.759	0.763
108	Indonesia	0.585	0.626	0.665	0.682	0.711
109	Vietnam	…	0.618	0.661	0.696	0.709
129	Cambodia	…	…	0.536	0.545	0.583
130	Myanmar	…	…	…	…	0.581
133	Laos	0.425	0.451	0.488	0.523	0.553

Source: UNDP. *Human Development Report* - 2006.

Since the early 1990s, there have been all sorts of international initiatives to assist the Mekong-Delta countries. With the admission of CLMV into the ASEAN, there are now ASEAN initiatives (e.g., the IAI Work Plan) targeted at these countries. Between 1995 and 2004, Viet Nam improved its HDI reading from 0.661 to 0.709, that is, an increase of 0.048 point, without the help of IAI Work Plan. Assuming that Cambodia, Myanmar, and Lao PDR are able to improve their HDI readings by a very improbable 0.048 point between 2004 and 2015 with the help of the IAI Work Plan, while the HDI readings of the rest of the ASEAN countries remain stagnant at the levels achieved in 2004, these three countries still will not be able to catch up with the rest, not even with Viet Nam.

Various initiatives have been put in place to assist CLMV. It specifically looks at the IAI Work Plan projects, analyzing how effective they have been.

3. CLMV-FOCUSED COOPERATION AND ASSISTANCE

International attention started to focus on CLMV in the early 1990s after the end of the Cold War and the Cambodian civil war, and when the free market reforms were launched in said countries, which started in the late 1980s. The 1990s saw the creation of various international forums and cooperative efforts to promote development in the Mekong region. The efforts include, among many others, the following:

3.1 ADB-sponsored GMS Economic Cooperation Programme

Since 1992, the countries of the Greater Mekong Sub-region (GMS)—Cambodia, Lao PDR, Myanmar, Viet Nam, Thailand, and the Yunnan Province of the People's Republic of China—have embarked on a programme of economic cooperation, with the support of international organizations. The programme has so far managed to achieve results that are more tangible and carried more impact on regional cooperation. The high-priority subregional development projects include projects in transportation, energy, telecommunications, environment, human resource development, tourism, trade, private sector investment, and agriculture.

3.2. Working Group on Economic Cooperation in Indochina

The Working Group, which was organized under the umbrella of the ASEAN and Japanese economic Ministers Meeting (AEM-MITI), held its first meeting in 1995. It targeted countries that were not regular ASEAN members—Lao PDR, Cambodia, Myanmar, and initially, Viet Nam. The Working Group aims “to promote the economic development of Cambodia, Lao PDR, and Myanmar and also to promote economic growth of the Southeast Asian region as a whole by strengthening the economic linkages between these countries and other ASEAN countries.”

3.3 ASEAN Mekong Basin Development Cooperation (AMBDC)

Initiated by the ASEAN, ten Southeast Asian countries and China attended the first Ministerial Meeting in 1996. The objectives of this cooperative effort were: (1) to enhance economically sound and sustainable development of the Mekong Basin; (2) to encourage a process of dialogue and common project identification that can result in firm economic partnerships for mutual benefit; and (3) to strengthen interconnectivity and economic linkages between the ASEAN members and the Mekong riparian countries.

The ASEAN’s efforts to help tackle the Mekong region's development issues and challenges were shelved temporarily during the 1997-1998 Asian financial crisis when the members of the group became too engrossed with their own domestic economic problems. But as Asia started to recover from the financial crisis, the Mekong development moved back onto the ASEAN's agenda.

The ASEAN leaders agreed at the 2004 Vientiane Summit to pursue comprehensive integration of the ASEAN into an ASEAN Community by 2020. At the ASEAN Economic Ministers Meeting in Kuala Lumpur on August 24, 2006, the member-countries agreed to accelerate the objective of the ASEAN Economic Community by 2015. The ASEAN Economic Community is the realization of the end-goal of economic integration, as outlined in the ASEAN Vision 2020: to create a stable, prosperous, and highly competitive ASEAN economic region in which there is a free flow of capital, equitable economic development, and reduced poverty and socio-economic disparities by 2020. Reducing development gaps among the ASEAN members are firmly manifested and embedded in the Hanoi Plan of Actions, the Bali Concord II, and the Vientiane Actions Programme

In the light of these developments, correcting the so-called "ASEAN divide" became a high priority. There was a greater commitment toward assisting CLMV to ensure that no one is left behind.10 Solidarity would be affected if the divide would not be eliminated. To help hasten the economic development of CLMV and, hence, narrow the development gap between these countries and the more-developed ASEAN-6, ASEAN leaders agreed in November 2000 to launch the Initiative for ASEAN Integration (IAI).

In the meantime, the AMBDC resumed its activities. It held its second ministerial meeting in 2000. At its third ministerial meeting in October 2001, it was agreed that Japan and South Korea would be taken in as additional members. Projects related to infrastructure, trade and investment, agriculture, forestry and minerals, industry, tourism, HRD, and science and technology have been implemented or are ongoing, but there have been financing problems.

At the Eighth Ministerial Meeting of the AMBDC in August 2006, the member-countries agreed to provide recommendations to place the AMBDC Ministerial Meeting under the ASEAN Economic Ministers Meeting process at the 12th ASEAN Summit in December 2006. The rationale given for the recommendation was that it would be easier to synchronize the economic integration activities, and, hence, would make maximum use of resources available.

New economic geography suggests that latecomers may utilize the dispersion forces due to congestion in economic agglomeration. The theory analyzes two forces in economic agglomeration: the agglomeration forces and the dispersion forces. The agglomeration forces may enlarge disparities among the integrated countries (e.g., CLMV versus other countries) as well as among domestic regions in each country (e.g., inland versus coastal regions in China). At the same time, the dispersion forces may move manufacturing activities from forerunners to latecomers, and narrow development gaps. The balance of these two forces would largely determine the overall effects of economic integration on industrial location patterns among the East Asian countries. From the viewpoint of CLMV, how to take advantage of the dispersion forces would become an issue.

There is, in fact, a sign of congestion in economic agglomeration in East Asia, and the dispersion forces start working so as to influence industrial location. We observe substantial increases in production costs in agglomeration due to difficulties in securing labour and land, traffic jam problems, among others. Companies have to find labour from distant places, and some of them eventually set up a new factory in middle-size cities or rural areas. In particular, labour-intensive or land-intensive production processes tend to shift. In the last several years, many cities have been growing with increasing number of residents, factories, and warehouses. For instance, in Thailand, factories are located in concentration in Lamphun, 50 kilometer south of Chiang Mai. In Malaysia, many parts suppliers are in Johor, and Malacca, where a superhighway is connected from Singapore to Kuala Lumpur.

The fragmentation theory, on the other hand, suggests that the differences in location advantages, such as factor prices, motivate fragmentation of production processes. Differences in wage levels between the ASEAN forerunner countries and CLMV are still substantial, and thus CLMV may have strengths, particularly for labour-intensive or natural resource-intensive production processes. The issue would be the network-setup cost and the service link cost. Their geographical proximity to growth centers would be a strong point, but drastic reduction in the setup cost and the service link cost would be required. Efforts for deeper integration would also be essential to preparing necessary policy environments.

To summarize, latecomers, particularly CLMV, have good opportunities for attracting economic activities in the globalization era. By strategically improving policy environments, they can attain two objectives at the same time: deepening integration and narrowing development gaps.

It is vitally important to understand the extent of the influence of the global value chain (GVC) and de jure regional trade agreements on regional production networking. Global business corporations have extended their production, material and resource sourcing, and markets beyond their domestic economies. Because of the pressure of integration, competition and JIT production system, East Asia is now fully connected into a global value chain system in which it produces the world production output. The importance of production networking, clustering (agglomeration) and fragmentation must be factored in de jure regional FTAs. There are some studies related to the importance of this issue. What is needed is to focus the linkage and relevance of de jure regional trade and investment arrangements with the accelerating process of production networking. A study should be conducted to examine specific trade and investment areas and sectors that require further government support and facilitations arising from trade and investment agreements.

Economic integration in terms of production networking or value chains has not benefited much from formal regional trade agreements. The basic weaknesses of the ASEAN Free Trade Area (AFTA), the ASEAN Economic Community (AEC), the ASEAN Investment Area (AIA), and the ASEAN Framework Agreement on Services (AFAS) consist of the too many exceptions on key sectors of ASEAN economies, as well as the inadequate standardization and harmonization of rules and regulations (including the existence of nontariff barriers). Transportation, infrastructure, and institutions to implement those trade and investment agreements are either not present or inadequate.

Production network and regional economic integration in Southeast and Northeast Asia, within the framework of global value chain and expanding production network in East Asia, are picking up speed. They are motivated basically by market-driven forces of competition, the rise of China and India, the political stability in the region relative to other regions, and the availability of productive labor force and resources buttressed by individual country's macroeconomic regime and liberal trade and investment regimes that promote economic development.

Despite many distortions and inefficiency in implementing the ASEAN regional cooperation schemes, there are many cumulative positive effects on the rapidly emerging production networking and agglomeration of industry in East Asia. The clustering of automobile industry and parts in Thailand, the clustering of electronic industry in Malaysia, and the knowledge-based industry cluster in Singapore are cases in point. Indirectly, positive and business-friendly policies and institutional environments in Southeast Asian countries have undoubtedly contributed to the emergence of industrial clustering and agglomeration and production network particularly in parts, components, and intermediate inputs in some sectors and in some selected Southeast Asian countries.

Further and enhanced efforts to accelerate and integrate existing agreements in goods, services, and investment are vitally important for ASEAN economies to meet the challenges and opportunities related to the rise of China and India and the accelerating process of global value chain development trend.

In the case of CLMV, these countries require development assistance in addition to the ASEAN regional economic integration. Without adequate development assistance, trade and investment liberalization alone would not be sufficient for these countries, perhaps with the exception of Viet Nam, to benefit from the emerging production networking and industrial clustering in Southeast Asia. That's because their infrastructures and institutions are yet to be developed.

Economic integration through regional and bilateral FTAs can enhance regional production networking if policy makers can minimize the distortions related to regional and bilateral FTAs in East Asia. Since 2000, bilateral FTAs and subregion FTAs have proliferated in East Asia. What is the nature of the proliferation FTAs in East Asia? Those bilateral FTAs are based on reciprocal preferential tariff schemes. Both parties choose its own sensitive lists. This implies that, for example, the ASEAN-China FTA (ACFTA) is counted as 10 separate bilateral FTAs between China and the 10 ASEAN countries. The degree of market access faced by an ASEAN exporter varies according to the ASEAN destination markets. This means that there are 45 bilateral preferential trade relationships within 10 ASEAN countries (10 x 9/2=45). In the same way, ASEAN-Japan FTA, ASEAN-Korea FTA, and ASEAN-India FTA are 10 separate bilateral FTAs each. ASEAN-CER (Australia and New Zealand) is 20 bilateral FTAs. A total of 105 ASEAN FTAs are enforced and/or under negotiation. Any ASEAN exporter faces different preferential treatments based on destinations. Baldwin (2006) has called the overlapping FTA problem as East Asian “noodle bowl syndrome.” Potentially, 16 countries would produce 120 bilateral FTAs (16 x 15/2) in the region.

Different FTA strategies by individual country may create severe overlapping FTA problems with various kinds of FTA. Because of the different FTA strategies taken by each country, there are much heterogeneity in exclusion lists, tariff rates, rules of origin, dispute settlement mechanism, mutual recognition, competition policy, and other norms and regulation among existing multilateral FTAs in Asia. The overlapping FTAs would complicate tariff rates and Ro0 on the same products, according to destinations. It is commonly agreed that the costs arising from the Ro0 are expected to increase substantially when countries experience overlapping of multiple FTAs/RTAs.

Other than the lack of FTA management arising from different FTA strategy and overlapping issues, there are some crucial impediments in the East Asia’s bilateralism. First, except for a few countries, East Asia has failed in forming high level FTAs in terms of trade liberalization. Reduction in agricultural trade barriers is important for narrowing development gaps. Agricultural products, however, tend to be excluded from preferentialtariff treatments.

Moreover, the bilateral FTAs in East Asia have addressed trade liberalization in goods, while liberalization in service trade has not progressed much in East Asia's FTA bilateralism. In short, economic integration in East Asia still remains "shallow." There are limited benefits from such integration, since there are much border-related barriers other than tariffs. A study estimates that trade costs of developed countries total 170 percent, of which 21 percent come from transportation of goods, 44 percent from border-related trade barrier, and 55 percent from retail and wholesale distribution costs. The study suggests that tariff reduction can partly reduce border barriers. Considering that East Asia's border trade barriers other than tariff are greater than those in developed countries, this region can considerably benefit from reduced border barriers.

Present trade patterns are very different from the past patterns as global competition emphasizes economies of scale. Production process involves sequential stages of production located across countries. Different stages of production are divided among different suppliers that are located in different countries. Products traded between companies in different countries are intermediate goods instead of final products, and final products are sold outside the region in which international division of labour in production process happens either intra-firm or inter-firm. This phenomenon is known by many names: production fragmentation, slicing up the value chain, vertical specialization, and production network.

The practice of dividing production process into many stages and locating it in different countries has progressed significantly and is gaining speed in East Asia. Theoretically, it has been confirmed that in such vertical specialization, a slight decline in trade costs induces large trade in intermediate goods, since goods are traded across borders many times.

The policy environment for trade facilitation in East Asia varies considerably by country. For example, customs clearance time in one country is quite different from that of another country. Customs procedures in many countries in East Asia are still complicated and lack transparency. This means that the policy space to facilitate trade or reduce trade costs remains wide. If trade facilitation measures, such as simplification and harmonization of customs procedure, paperless trading, and mutual recognition, are improved, trade costs will be reduced and production network will be expanded to a considerable extent.

The enhancement of logistic infrastructure system, including institutional system, is an issue that should challenge policymakers in East Asia toward realizing deep integration, since this will facilitate trade and location of production. The study on cross-border trade facilitation for ASEAN countries by JETRO (2006) reveals that goods between Bangkok and Hanoi, for example, were transported mainly by sea. This does not fit the “just-in-time” production operation prevailing in other parts of East Asia. JETRO study suggests that if logistic infrastructure system, such as road networks, transportation terminal facilities, and legal institution, is developed and established, then trucking transportation would increase.

4. Conclusion

Intraregional trade and investment have been developed through production networking in terms of regional division of labour and vertical specialization. Since the Asian Financial crisis in 1997 and the rapid rise of China, production networking has considerably developed in East Asia, Northeast Asia, and Southeast Asia. However, the pattern of industrial development in East Asia is not even and there are many existing structural and policy impediments to regional economic integration, resulting to growth gaps.

In the past, regional economic integration was largely driven by market forces and supplemented by subregional and bilateral FTAs. Since 2000, the impetus of regional integration by way of initiating and establishing subregional and bilateral FTAs has increased considerably. However, due to different FTA strategies adopted by regional countries and the proliferation of low-grade FTAs, subregional and bilateral FTAs have resulted to duplication and overlapping rules of origin, dispute settlement mechanism, and competition policy, as well as other distortions in trade and investment regimes. These constraints tend to increase transaction costs and trade barriers despite continuing reduction in average tariff rates in developing countries in East Asia. Increased transaction costs would tend to reduce industrial dispersion effect in less-developed economies in the region and, thus, the phenomenon of growth gaps in East Asia would tend to persist.

To minimize this trade and investment distortion and increase production networking, economies in the region must aim for high-grade FTA and consolidate the existing plethora of bilateral FTAs. Equally important is policy priority to harmonise customs procedures, mutual recognition of standards, and improvement of infrastructure and other capacity-building efficiency to facilitate cross-border trade. Such policy initiatives and measure would invariably enhance the capacity and competitiveness of the regional economies to leverage the ever-accelerating globalization through global value change (GVC) trend, regional division of labour, and vertical specialization of production process, which is operating more strongly in East Asia than in any other region.

As part of global value chains (GVC) production network, CLMV must be part of the global value chains process for CLMV to prosper. In other words, individual CLMV economy must identify its specific market and production niches and contribute to the overall regional and global production network. Such development strategy applies particularly to countries that have small domestic market and lack in marketable commodities and resource endowment (Cambodia and Lao PDR may be cited as case in point). Development strategy of Cambodia and particularly Lao PDR necessitates the identification of their specific market and production niches, which can contribute to the production network of the much larger and more-developed economies such as Thailand, Viet Nam, and China.

More than the need for trade and investment liberalization, CLMV economies urgently need to undertake long-term, consistent, effective domestic restructuring, as well institutional and organizational reforms. Likewise, there is a need to institute transparency and enforce legal framework and good governance through effective civil service administration.

Without those internal reforms, FDI, under the impetus of globalization and regional trade and investment agreements, tends to gravitate to more efficient and developed economies and therefore aggravate the widening development gap in East Asia.

Any regional integration requires the provision of regional public goods by more developed and stronger economies. A case in point is the role of Germany and France in providing regional public goods in the early formative years of the European Economic Community (EEC). These public goods can be in the form of technical assistance, grants-in-aid, concessionary loans (ODAs), preferential market access without reciprocity, and other privileges. The provision of these regional public goods is often referred to as "enabling clause," with the objective to establish human and institutional capacity for the less-developed members. Over a period of time, a level playing field may emerge, which would contribute to the realization of more prosperous, competitive, and equitable ASEAN economies as envisioned in the ASEAN Vision 2020.

It should therefore be the collective responsibility of more-developed ASEAN members to undertake a long-term initiative in providing adequate public goods to CLMV. Such as strategic approach would go a long way in establishing a sense of shared prosperity and in strengthening community value and regional identity as embedded in the ASEAN Social and Cultural Community.

In this context, the ASEAN-6, on a bilateral basis, have contributed about USD$159.4 million to CLMV to implement various projects and a total of 55.5 percent of the total funding required in the Integrated ASEAN Initiative (IAI). However, much more resources need to be provided in the areas of infrastructure, human resource development, information, communications technology, and customs capacity improvement. In addition, the ASEAN Development Fund (ADF) is up and running with contributions from Australia and India, and to a large extent from Japan through Japan-ASEAN Integration Fund (JAIF) to provide funds for the implementation of Vientiane Actions Programme.

Towards this objective to reduce development gaps, there are existing regional and bilateral mechanisms to implement development assistance to CLMV. Greater Mekong Sub-regional (GMS) Initiative provides a comprehensive framework of development programme. Through the ASEAN-Mekong Basin Development Cooperation, the programme encompasses the ASEAN Highway Network; the ASEAN East-West corridor across Viet Nam, Lao PDR, Cambodia, Thailand, and Myanmar; the Singapore-Kunming Rail Link; and the ASEAN energy network. In this respect, Japan has committed to providing more than $3-billion assistance to ASEAN for human resource development and exchange programme for the development of the Mekong sub-region.

What is also urgently needed is a sense of priority and political commitment to implement those agreed initiatives and programmes based on existing mechanism. With greater and consistent assistance in providing regional public goods, the GMS assistance, accompanied with timely and correct domestic reforms, CLMV would gradually integrate with the rest of ASEAN as envisioned in the ASEAN Vision 2020.

Reducing development gap is an important and strategic measure that will establish ASEAN as a credible and dynamic regional organization ready for economic integration and the ASEAN Community by 2020. Economic integration goes parallel with economic competitiveness. To meet the economic challenges that go with the rise of China and India, ASEAN has to establish a single market and production base of 550 million people.

Without adequate and consistent development assistance to less-developed economies of CLMV, trade and investment liberalization and domestic reform measures would not be sufficient to engender a sustained overall development for CLMV. To enable these countries to participate and contribute fully to regional integration, development agenda are more important than liberalization in trade and investment at this stage of their development.

The framework for reducing development gap is already in place. ASEAN needs policy focus as well as coordination and political commitment among more developed members and their external partners, particularly within the ASEAN-Plus-Three (APT) framework, to provide regional public goods (external economies) for their less-developed ASEAN members.

5. Policy Recommendations

1. Initiate and set up multilateral stakeholder fund and a commitment to increase and coordinate intra-ASEAN Official Development Assistance (ODA);

2. Accelerate economic integration measures as embodied in the Bali Concord II to increase ASEAN economic competitiveness as an important mechanism to reduce development gap;
3. Undertake a study to identify policy measures to attract FDI into infrastructure development in CLMV through a series of workshops organized to review the recommendations of the study and formulate an implementation strategy;
4. Emphasize intra-ASEAN assistance for education and technical trainings for the youth;
5. Initiate infrastructure joint development in CLMV to support economic integration;
6. Strengthen coordinating mechanism within the existing subregional arrangements in the ASEAN;
7. Develop subregional and bilateral trade and investment agreements consistent with wider regional agreement and will eventually converge to minimize trade and investment distortions and duplications of rules; and,
8. Establish a scheme to reduce development gaps, which is consistent and in line with the increasing competitiveness in ASEAN and moving towards a single market and production base.

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Chapter 2

ECONOMIC INTEGRATION AND DELOPMENT STRATEGIES: A THEORETICAL PERSPECTIVE

Koji Nishikimi

ABSTRACT

Economic integration creates two different forces on industrial location: *dispersion* and *agglomeration forces*. The dispersion force relocates industries across integrated countries according to each country's comparative advantage and achieves the static efficiency of resource allocation. In contrast, the agglomeration force serves as a dynamic source of industrialization but at the same time, it may produce the economic disparities among integrated countries and among domestic regions within each country. In order to work out effective development strategies under the influence of the two forces, it is important to manage dexterously the nonlinear effects, such as *home market effect*, *lock-in effect* and *hub effect*. With these effects, drastic progress in long-term economic development can be triggered by a single success of a short-term program for inviting firms, particularly in the initial stage of agglomeration. Individual policies therefore bear great importance in the industrialization process, but the government of each country is likely to face two kinds of difficulties in developing a successful strategy: (1) strategy-building requires extremely accurate information about the state of the country; and (2) difficulty in policy coordination to avoid excess public investment for development.

1. INTRODUCTION

In East Asia, a large number of multinational enterprises have vigorously expanded their production networks since the 1990s. Moreover, from the beginning of the twenty-first century, increasing numbers of free trade agreements (FTAs) and economic partnership agreements (EPAs) have been concluded, and the economic integration has been rapidly progressing in this region on both *de facto* and *de jure* bases. The progress in integration promoted the intraregional division of labor in East Asia and thereby enhanced the production potentials of the region. As a result, the share of intraregional exports in total exports by East Asia has rapidly increased from 39.9 percent in 1990 to 51.1 percent in 2005, and their GDP share in the world has grown from 18.9 percent to 25.9 percent during the period 1990-2004. The progress in regional integration, however, has also generated serious concern over expanding economic disparities among integrated countries as well as among domestic regions in each country. For example, China encounters large and growing difference in production and income between costal and inland regions: the GDP share of the 11 costal provinces increased from 53.3 percent in 1990 to 61.3 percent in 2003, although these provinces occupy only 12.4 percent of China's land.

Economic integration is expected to create two different influences on industrial location. First, the international difference in comparative advantage leads different industries to different countries. As comparative advantage structures change over time, industries would disperse over many countries, and such a tendency becomes clearer as trade becomes more liberalized with economic integration (*the dispersion force of economic integration*). However, when there are significant economies of scale in production, firms tend to locate in countries/regions close to large markets so as to exploit the scale merits. This likely forms industrial agglomerations in a limited number of countries/regions, leaving other regions vacant (*the agglomeration force of economic integration*). Hence, with this second force, trade liberalization and capital mobilization tend to intensify the economic disparities noted above.

The relative size of the above two forces should largely determine the overall effects of economic integration on industrial growth of East Asian countries. It is regularly pointed out that the flying-geese pattern in Asia recently became more ambiguous than before, and this fact suggests that the agglomeration force has been getting dominant in East Asia. The current economic environment in this area might be rather tough for those countries/regions with small markets. In this chapter, we will study the desirable development strategies for the Cambodia, Laos, Myanmar and Vietnam (CLMV) economies, which joined the ASEAN in the late 1990s and now are vigorously try to catch up with other Asian countries. We attempt to find good ways to harness the two forces of integration for CMLV's growth and how to coordinate them with each country's strategy for development so as to make the Asian economic integration really fruitful.

In the following section, we look at how dispersion and agglomeration forces work in the process of economic integration. Then in Section 3, we examine the effects of these forces on resource allocation and economic disparity among countries and among domestic regions of each country. In Section 4, we investigate possible development strategies that appear to work effectively under the two forces.

2. TWO FORCES OF ECONOMIC INTEGRATION

As briefly discussed above, economic integration likely produces two different forces on industrial location, i.e., dispersion and agglomeration forces. It should be noted here that the industrial location pattern and the trade pattern are the two sides of a single coin. Both closely reflect the competitiveness of each country's products in the world market.

There are two major sources of competitiveness, *comparative advantage* and *home market effect*. The former source works in both cases with and without scale economies in production, while the latter works only in a situation with significant scale economies.

2.1 Dispersion force

First, let us examine the dispersion force on industrial location. This force arises from the comparative advantage structure among trading partner-countries.

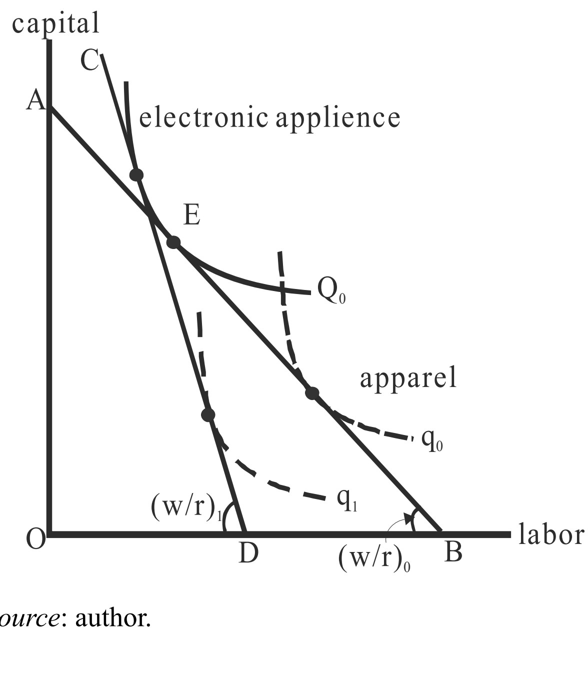
2.1.1 Comparative advantage and industrial location

Asian countries exhibit wide differences in endowment of production factors such as land, capital, and labor with various skills and knowledge. For example, China is endowed with rich land resource and productive labor force, while Japan accumulates much engineering knowledge but has relatively small land and labor. The difference in factor endowment should be an essential determinant of the comparative advantage of each country. As factor endowment in a country changes with accumulation of physical and human capital, for example, the industrial structure of that country (and perhaps, of its trade partners) may evolve reflecting the comparative advantage.

Figure 1 shows a situation where labor becomes scarce relative to (physical and human) capital in a country that produces electronic appliance and apparel, which are characterized as capital-intensive and labor-intensive, respectively. Suppose that, initially, both industries have faced a wage-rental ratio given by $(w/r)_0$. Note that all points on line *AB* show the factor inputs that require identical total cost, for example, a dollar. Hence Q_0 units of electronic appliance entail the same cost as q_0 units of apparel when the relative factor price is given by $(w/r)_0$. Now suppose that in this country, labor becomes scarce, so that the relative wage rises to $(w/r)_1$. Then, with this higher wage, the production cost of Q_0 units of electronic appliance is equivalent to that of q_1 units of apparel $(q_1 < q_0)$. In other words, the production cost of labor-intensive goods will increase as labor gets scarce. This may cause a loss of that country's global competitiveness in the labor-intensive goods, and these industries may relocate to more labor-abundant countries.

The above story in Figure 1 may describe the current state in China, where labor scarcity has appeared and real wage has started to rise. It is expected that some of the most labor-intensive industries will be spilled out of China in the near future. These industries may relocate to labor-abundant countries in Asia, including CLMV countries.

Figure 1: Wage rise and relocation of industry.



Source: author.

2.1.2 Flying geese pattern of industrial development

Applying the above view to a general case that includes many industries and many countries with variable factor endowments, we can imagine a dynamic process where industries trickle down from one country to another, reflecting the over-time changes in each country's factor endowment. This idea is often called the flying geese model of industrial development.

In the context of East Asia, Japan has played the role of the "lead goose" ---i.e., the first to start operating the new industries in the area. As it gains advantages in production of more advanced goods, Japan successively releases industries in which it no longer holds a comparative advantage. Then, these industries relocate to nearby less-developed countries (the Asian NIEs), which, in turn, encourages relocation of some outdated industries in the "follower-geese" countries to the neighboring less-developed countries (ASEAN, China, and CLMV). This flying geese model fits the "catching-up" industrialization of Asian economies until the 1980s. More recently, however, the flying geese pattern in East Asia has become vague and more complicated with multiple lead geese, as asserted by Fujita and Hamaguchi (2007).[1]

2.1. 3 Fragmentation

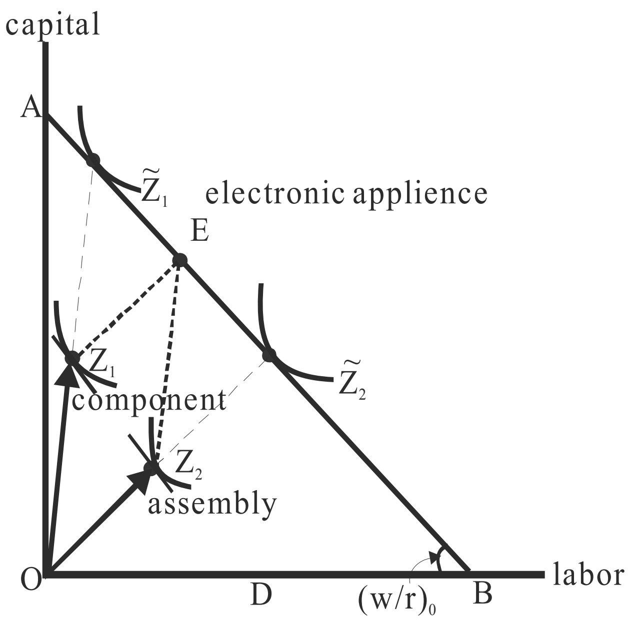
The traditional arguments on comparative advantage and the flying-geese industrialization have focused on production of final goods. In Asia, however, the international division of labor has recently made substantial progress, particularly in the

[1] In the 1990s, the Asian NIEs caught up with Japan in certain technological areas such as semiconductors and information and telecommunication equipment (i.e., notebook computers and mobile telephones). On the other hand, China emerged not only as a location for cheap labor but also as a huge consumer market. These might be caused by the agglomeration forces of *de facto* economic integration, which would be discussed in the following sections of this chapter.

production of intermediate goods. Many enterprises in the automobile and electronics industries, for example, separate several processes of production and relocate them to different countries, according to the market conditions prevalent in each country. This phenomenon is often called fragmentation and has been intensively studied since the late 1990s.[2]

In the case of firms that apply fragmentation, the industrial location pattern can be basically described by the same theory of comparative advantage, as shown by Jones and Kierzkowski (2001) and Deardorff (2001).[3] For example, suppose that the production of the electronic appliance given by point *E* in Figure 1 can be separated into two subprocesses, production of components (Z_1) and assembly (Z_2), as depicted in Figure 2. In the figure, we assume that the process of component production is more

Figure 2: Fragmentation.



Source: author.

2 For detailed analysis of fragmentation, see Arndt and Kierzkowski (2001) and Jones (2000).
3 Here we assume that the production process in a fragmenting firm is characterized by constant returns to scale. When it is subject to increasing returns to scale, the location pattern is affected by home market effects as well as comparative advantage, as discussed in detail in the next section.

capital-intensive than the assembly process. Recall that line *AB* in Figure 2 (and Figure 1) represents a-dollar-worth inputs of capital and labor when the relative wage is given by $(w/r)_0$. Hence $\tilde{Z}_1$ units of the components cost as much as $\tilde{Z}_2$ units of the assembly service. If labor becomes scarce, the relative wage will rise. This makes assembly service more expensive and encourages the electronics firms to relocate their assembly process to countries where labor is more abundant and cheap. Clearly, this process of fragmentation is caused by the same mechanism of comparative advantage as the location process of the final-good industries, which is drawn in Figure 1.

In addition to changes in factor prices, a decrease in international transportation and communication costs among various location sites will encourage firms to apply fragmentation and build up their global intra-firm production networks, which enables more effective exploitation of the location advantages. In this sense, economic integration promotes global dispersion of industries.

2.2 Agglomeration force

2.2.1 Home market effect and industrial agglomeration

The origin of the agglomeration force can be found in the scale economies of production, which we temporarily set out of our view in the preceding section for the sake of analytical simplicity. Suppose that manufacturing process of sector *M* (the electronics sector, for example) is characterized by increasing returns to scale. We also assume that international transportation entails significant cost, while domestic transportation costs are negligible. Then, if *M*-firms produce the same homogeneous good, all domestic production of *M* should be supplied by a single firm as a result of competition. In this case, because of the scale economies, an *M*-firm operating in a country with large markets can produce at lower cost, hence, tends to be more competitive in the world market. Then, export brings more production and higher efficiency to these firms. This, in turn, lowers the domestic price of M, which makes the consumers in that country better off. In short, the size of the home market affects the real income (utility) of the consumers in that market. This mechanism is often called *home market effect*.

The above story of natural monopoly with homogeneous M-products gives a simple and clear picture of the home market effect, but the result may seem to rely heavily on the assumption of pure monopoly in M-market, which is seldom observed in the real economy. Then one may wonder if home market effects can be obtained even when the market is not purely monopolistic. When manufactured goods are not homogeneous but slightly differentiated from each other, there should be multiple (or even many) producers at an equilibrium. Such situations are lucidly described by the monopolistic competition model of Dixit and Stiglitz (1977). In their model, each firm exhibits increasing returns to scale; hence, each variety of manufactured good, M_i, gets cheaper as its home market becomes large. When the price of M_i declines, however, consumers may spend their spare money to buy a new variety of M, rather than to increase their purchase of the existing varieties. In fact, at the equilibrium of monopolistic competition in Dixit and Stiglitz (1977), an increase in market size does not affect the production quantity of each firm but increases the number of varieties of manufactured goods. In this case, consumers enjoy higher utility with consuming a wide variety of M-good. Accordingly, the size of the market affects the real income, and the home market effects are therefore at work in the case with many M-firms, too.

Incorporating domestic transportation costs into the above model, we can obtain a domestic version of the home market effect: A large market attracts producers of a wide variety of differentiated goods and gives consumers higher utility by providing those goods at cheaper prices. In addition, for the case of the domestic economy, it should be natural to allow labor (= consumer) migration across regions. With labor migration, the home market effect works more extensively by forming a circular effect between demand and supply growth: Labor (= consumer) migrates to the place where a wide variety of consumer goods are available, and this brings more income to spend at the market there, which in turn attracts more firms to that place. As a result, there emerges a large agglomeration of producers and consumers.[4]

2.2.2 Effects of transport hub

Other than the labor migration discussed above, there are several factors that form circular effects and stimulate the agglomeration mechanism. Formation of transport hubs is perhaps the most popular factor.

The basic mechanism of hub-formation originates from scale economies in transportation, which have been realized by the development of large-sized and high-speed carriers, such as large container ships, bullet trains, and jumbo jets. The scale economies provide an incentive for collective transportation and hence stimulate the development of transport network systems with trunk routes and the hub-spoke structure of transportation.

Trunk routes often arise from the following circular causations. Suppose there are regular services of transport on a given link. If this link is used, shippers can save substantial costs from seeking a transporter for individual shipment. This attracts many shippers to use this link, which in turn supports even more frequent transport services in

[4] For detail of the agglomeration mechanism, see Fujita *et al.* (1999) and Baldwin et al. (2003).

the link. This positive feedback mechanism eventually leads to the endogenous formation of a trunk link and transport hubs at the two ends of the link. When scale economies in transportation rule the transport advantage of each location, a major transport node (hub) can spontaneously emerge at any place that has a large transport demand such as the sites of industrial agglomeration.

Once a hub-spoke structure arises in a transportation network, the hub attracts many producers and consumers by its significant transport advantages. This will switch on the reciprocal reinforcement process between transport hub and industrial agglomeration.[5]

2.2.3 Specific labor market

Another stimulation factor of agglomeration emerges when a pooled market for workers with special skills is formed. Such a market benefits both workers and firms as Marshall pointed out in his 1920 book:

> [A] localized industry gains a great advantage from the fact that it offers a constant market for skill. Employers are apt to resort to any place where they are likely to find a good choice of workers with the special skill which they require; while men seeking employment naturally go to places where there are many employers who need such skill as theirs and where therefore it is likely to find a good market. The owner of an isolated factory, even if he has good access to plentiful supply of general labour, is often put to great shifts for want of some special skilled labour; and a skilled workman, when thrown out of employment in it, has no easy refuge. (Marshall 1920: 271-272)

[5] This reciprocal reinforcement is often called *hub effect*. For detail of the hub effect, see Krugman (1993), Fujita and Mori (1996), and Mori and Nishikimi (2002)

In the modern context, the most prominent example of this factor should be perhaps given by the case of IT clusters in Silicon Valley and Bangalore, where a large mass of IT firms and high-tech engineers have established a pooled market and attracted more firms and engineers.

2.2.4 Local Spillover Effects

Industrial agglomeration can be also caused by local spillover of information. Up-to-date knowledge of production technologies and market trends often plays a key role in many fields of business. Hence, individual producers always try to accumulate and update their knowledge bases. Such knowledge and information tend to spill over from one producer to another through face-to-face business contacts, close monitoring of rival firms and other daily communications, all of which should be easy if producers operate together in a same production site. As a result, firms in the same industry or closely related sectors are likely to be agglomerated. When a large number of firms are clustered in a small area, competition among them becomes severe, so that the firms naturally get specialized in slightly different products. This leads to monopolistic competition and creates a circular causation of further agglomeration via home market effect, as discussed in Section 2.2.1.

It should be noted here that in reality, the above forces of agglomeration often appear to operate together, so that we cannot simply identify the main factor of an existent agglomeration. For example, suppose a significant number of IT manufacturers operate side-by-side to exploit the information spillover effects. This may create a local market of high-tech engineers equipped with special knowledge and skills for their production and R&D activities. As production increases, transport network will be developed to connect this site and major markets outside, and the site may become a transport hub if the transportation grows sufficiently. Once a hub emerges, it attracts large numbers of consumers as well as firms in various industries. All these factors interact with one another and create a large industrial cluster.

3. RESOURCE ALLOCATION AND DISPARITY EFFECTS OF INTEGRATION

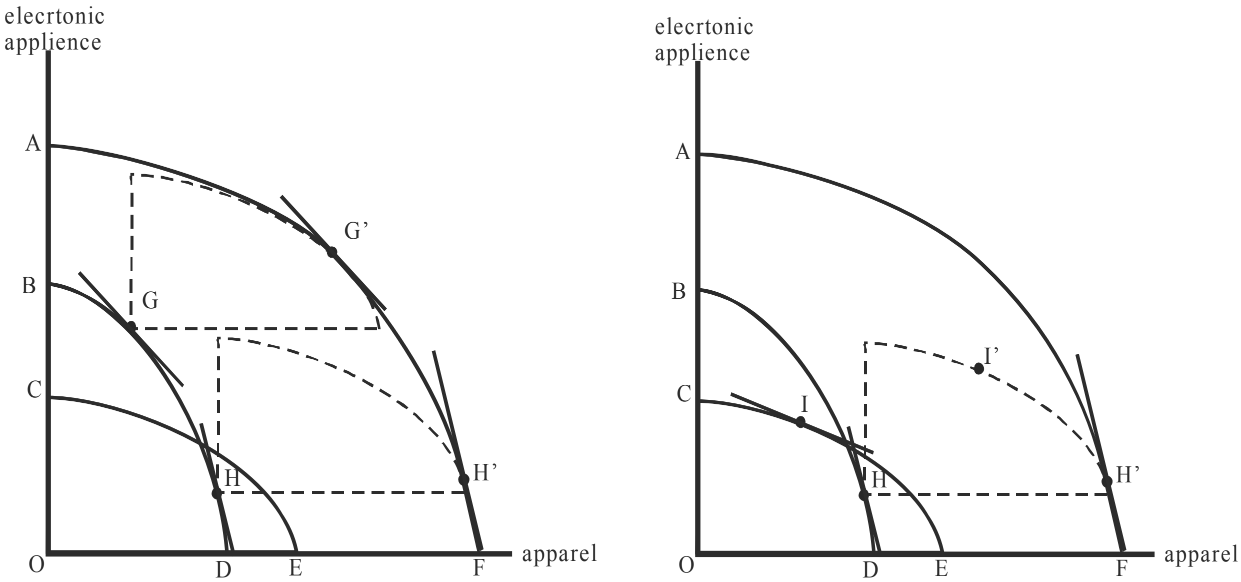
3.1 Resource allocation effects

The dispersion and agglomeration forces bring different effects on resource allocation in the integrated economy. In the case of industries without scale economies, a competitive equilibrium with the dispersion force achieves a Parato optimal allocation. In contrast, if scale economies are at work, the agglomeration force may well bring about an inefficient allocation of resources. Below, we look at the allocation consequence of each case.

3.1.1 Efficiency gains from trade liberalization

First, let us examine the allocation effects of trade liberalization in a case without scale economies. Suppose two countries are being integrated. They produce two goods, electronic appliance and apparel, which are respectively capital-intensive and labor-intensive sectors, as in the case shown in Figure 1. Country 1 is assumed capital abundant, while Country 2 is labor abundant. In Figure 3, curves *BD* and *CE* depict the production possibility frontiers (PPF) of Countries 1 and 2, respectively. Sliding the PPF of Country 2 along Country 1's PPF, we can draw the envelope *AG'H'F*, which represents the PPF for the integrated economy of Countries 1 and 2. Note that total production *OG'* can be decomposed into Country 1's production *OG* and Country 2's production *GG'*. Moreover, the slopes of the three PPFs (marginal rates of transformation) are all equal at the corresponding points, *G* and *G'*.[6] It should be noted that market competition leads producers to achieve a production point where the slope of PPF is equalized to the relative price of the two products. Hence, free trade equilibrium realizes an efficient production in the integrated countries, such that the production point locates on the frontier PPT curve *AH'F* in Figure 3.[7]

Figure 3: PPF and Production Efficiency in the Integrated Countries.



(a) PPF for the integrated economy (b) efficiency of resource allocation

Source: author.

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6 This can be verified by using the envelope theorem.

7 In addition to the production efficiency discussed in the text, efficiency in consumption is also realized at a competitive equilibrium under free trade. For details, see standard textbooks on microeconomics.

Now, suppose import taxes are levied, so that the relative price differs between Countries 1 and 2. Production in the two countries will occur at the points where the slopes of their PPFs are different, for example, at points *H* and *I* in the right panel of Figure 3. In this case, total production in the two countries is given at *I'*, which locates in the interior of the production possibility set, *OAF*. This resource allocation is not efficient because the production of both goods can be increased if resources are relocated so that Country 1 produces more electronics and Country 2 provides more apparel.

Such production can be achieved by eliminating the import taxes. In fact, if all tariffs are completely removed, then all producers in the two countries encounter the same product prices. This leads production in the integrated economy to a point on the envelope that achieves a Parato optimum allocation of resources. In other words, trade liberalization accompanying the process of economic integration will improve the efficiency of resource allocation in the integrated economy as a whole.

It should be noted that trade liberalization brings about an efficient resource allocation even for cases where firms apply fragmentation. As was discussed in an earlier section in this study, the location of producers of intermediate goods is affected by the comparative advantage structure basically in the same way as that of final-good producers. Hence, not surprisingly, trade liberalization brings about a gain in efficiency in resource allocation. Moreover, a decrease in international transportation and communication costs that accompany the process of economic integration will encourage firms to relocate their production processes to countries where their necessary inputs are available at cheaper prices. Accordingly, economic integration will improve the efficiency in resource allocation for cases with or without fragmentation.

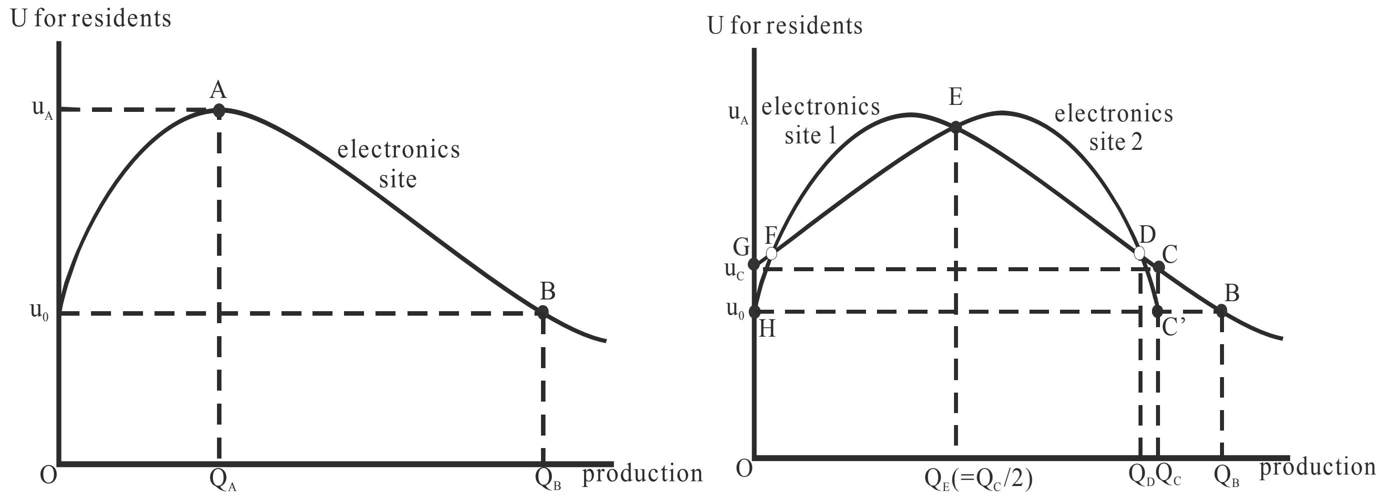
3.1.2 Allocation efficiency of agglomeration equilibrium

Next, we examine the allocation efficiency for cases where agglomeration forces are at work. The entire efficiency depends on how many industrial clusters exist in the equilibrium. Hence, the key question here is: Is there a reliable mechanism that generates the optimal number of clustering sites? In the real world, we often observe that new industrial clusters emerge in the process of economic growth. This suggests that market mechanism adjusts, to some extent, the number of clusters according to the size of the economy. However, it does not necessarily imply that the optimal number of industrial clusters are created by market forces. In fact, home market effect, which provides a main cause of the agglomeration force, tends to realize an excessively small number of large agglomerations.

Figure 4 shows how the home market effect hinders multiplication of clustering sites. Assume that, unlike in the previous examples, electronics manufacture is characterized by scale economies and, hence, by home market effects. Assume further that there is a single cluster of that industry at Site 1. If the production in Site 1 is sufficiently small as shown by the part of O-Q_A in the left panel of Figure 4, the utility of residents near the site rises as production increases, due to the home market effects. We further assume that the home market effect diminishes as the production becomes larger than Q_A, so that the utility at Site 1 hits the maximum at A and then decreases as shown in the left panel of Figure 4.[8]

[8] This occurs if there is a technological limit in product differentiation or if an expansion of employment and production in the electronics industry raises the prices of other products.

Figure 4: Allocation Efficiency with Home Market Effect.



(a) Single cluster (b) Two clusters

Source: author.

When demand for the electronic appliance increases, the agglomeration at Site 1 will continuously grow over the utility-maximizing size, Q_A. Of course, any electronics firm can start producing alone at a site outside the cluster. However, such a firm will face some difficulty in finding good workers because workers at the new site achieve less utility, u_0, than at the agglomerated site, due to home market effects. To keep workers in a small town, the relocating firm has to pay more wage than the agglomerated firms. As a result, home market effect tends to hinder the emergence of new clusters and make the existing agglomerations too large. Without policy intervention, the agglomeration at Site 1 will grow up to Q_B, where the utility level at that site equals to that at a potential new site.

Now suppose that the electronics production in Site 1 is given by Q_C in the right panel of Figure 4. In the figure, the production at the (potential) new site, Site 2, is measured to the left from Point Q_C, and the utility for Site 2's residents is represented by

Curve *C'EG*, which is drawn as a horizontal mirror of Curve *HEB*.[9] Since Q_C is smaller than Q_B, individual producers do not have sufficient motivation to start production in a new site. However, even in this situation, the creation of Site 2 will make both sites' residents better off. If the critical mass of production, Q_C-Q_B, is transferred from Site 1 to Site 2 (perhaps by some policy measures), Site 2 starts growing spontaneously because it provides greater utility than Site 1. When the production in Site 2 exceeds Q_C-Q_E, some workers and firms in Site 2 will go back to Site 1, where larger utility is attainable than in Site 2. Therefore, Point *E* represents a stable equilibrium with two agglomerated production sites.[10] Note that at Point *E*, residents in both sites achieve greater utility, as compared to the equilibrium with a single agglomeration. In other words, the equilibrium represented by Point *C* does not achieve the optimum allocation of resources while it is a stable equilibrium, too.

To sum, in cases where home market effect exhibits a reverse-U shape, market competition tends to hinder creation of new agglomeration. Economic liberalization accompanying the process of regional integration leads to excessive localization of producers with such effects.

3.2 Disparity effects

As we discussed in Sections 2.2 and 3.1.2, market forces lead the industries with scale economies to be localized in a small number of locations. Liberalization of international trade and investment encourages localization of such industries and intensifies economic disparities among integrated countries as well as among regions within each country.

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[9] For simplicity, we assume that the two sites provide identical conditions for production.

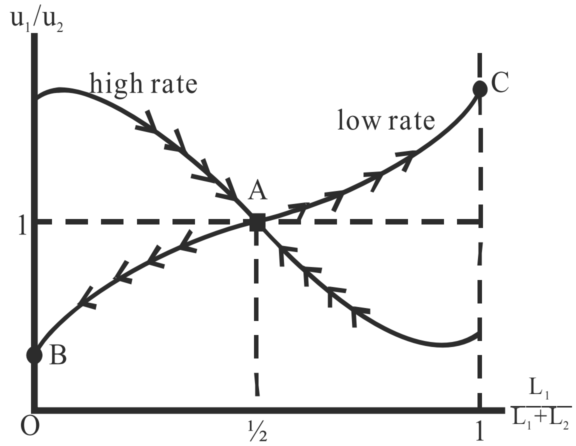
[10] In the right figure of Figure 4, there are three stable equilibria, Points *C*, *E* and *G*, and two unstable equilibria, Points *D* and *F*.

3.2.1 Transport costs and core-periphery structure

How integration widens regional disparity is well explained by the core-periphery model whose essence has been discussed in Section 2.2. Using a two-region economy model, Fujita *et al*. (1999) closely examine the stability of geographical configuration of industries and show that transport costs between the two regions play a critical role in creating a core-periphery structure in a regional economy. Figure 5 depicts their main results. The two curves in the figure show the relations between Region 1's labor share and the ratio of utility for Region 1's residents to that for Region 2's residents, for cases with high and low rates of transport cost, respectively. If transport is prohibitively expensive, an increase of labor in Region 1 lowers the price of its products and wage because supply growth does not meet the corresponding growth in export demand.

Accordingly, for the case where high transport rate exists, the relative utility of Region 1 is given by the downward sloping curve in Figure 5. By contrast, if transport cost is sufficiently low, a growth in the regional supply potential leads to an increase of real wage (in utility term) in that region, due to home market effects. Hence, for this

Figure 5: Stability of Equilibrium in Two-region Model.



Source: author.

case, the relative utility curve has a positive slope.

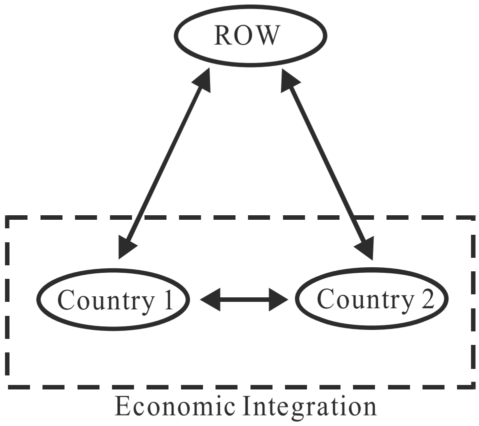
In both cases, the symmetric distribution of industries between two regions (represented by Point *A*) gives an equilibrium configuration. But the above-noted difference in slope of the curves produces a striking contrast in the stability of equilibrium between the two cases. When transport cost is sufficiently high, a small increase in Region 1's labor force lowers u_1/u_2, which attracts labor back to Region 2, and vice versa. The equilibrium point *A* is therefore stable. When transport cost is low, in contrast, a small increase of labor in Region 1 raises u_1/u_2 and encourages more migration. In this case, the symmetric equilibrium is not stable, and the regional economy will be led to an extremely unequal state, Point *B* or *C*.

The above result of Fujita *et al*. (1999) is quite suggestive for the case of economic integration, too. The process of economic integration is often accompanied with a decrease in transport costs in a broad sense, including pecuniary/time costs for transportation as well as tariff/nontariff trade barriers. If it produces a change in stability of the dispersed equilibrium, as shown in Figure 5, then it will suddenly create a large disparity among integrated regions.

3.2.2 Disparity among countries

Within East Asia, international mobility of products, materials and capital has been increasingly enhanced, but labor mobility is still substantially limited across countries, so far. Hence, so as to examine how regional integration affects economic disparity among the integrated countries, the core-periphery model discussed above needs to be modified for cases where labor mobility is restricted only within countries. To do this, Nishikimi (2007) extends the core-periphery model with footloose capital developed by

Figure 6: Three-country Model of Economic Integration.



Source: Nishikimi (2007).

Baldwin *et al*. (2003). He assumes three countries, Countries 1, 2 and ROW, of which Countries 1 and 2 are forming an economic integration as illustrated by Figure 6.

Each country is endowed with two kinds of production factors, labor and capital. It is assumed that capital is internationally mobile without cost, while labor is immobile across countries. These production factors are to be used in two sectors: differentiated manufacture characterized by increasing returns to scale (IRS), and agriculture with constant returns to scale (CRS). Products of these two sectors are traded among the three countries, but they involve transport charges. Suppose that transport between the integrated countries costs less than that between ROW and each of Country1 and 2.[11]

Now, the question is: What geographical distribution of the IRS manufacture will emerge in equilibrium? Figure 7 shows the relationship between transport cost and each county's share in world production of manufactured goods. In both panels of Figure 7, the vertical axis represents each country's share in manufacturing, s_n (n=1,2, ROW), while the horizontal axis gives the "freeness of trade" within the integrated economy, f,

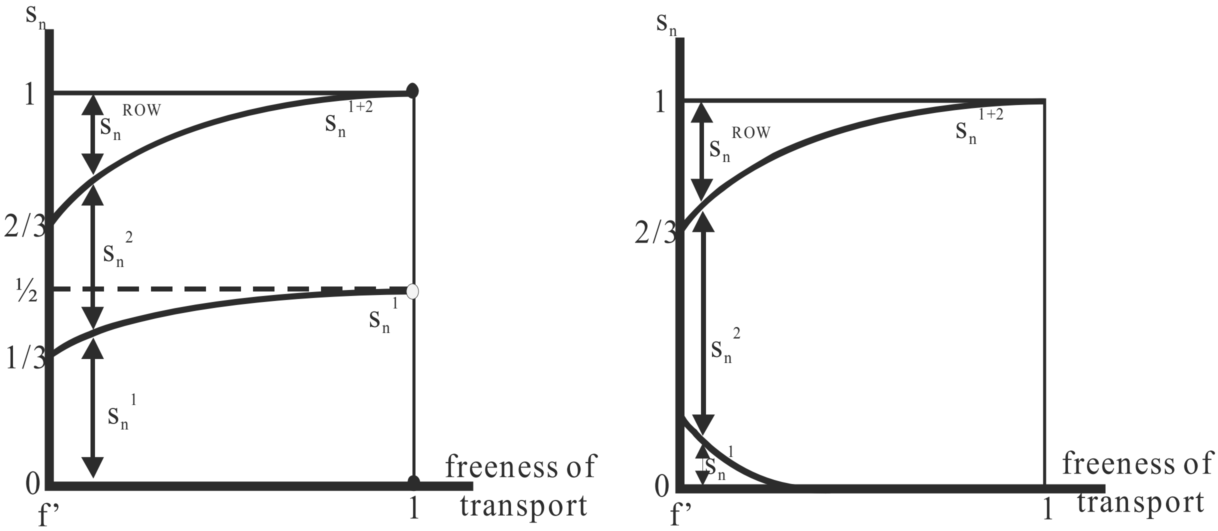
[11] Nishikimi (2007) simply assumes that transport cost between ROW and Country 1 equals to that between ROW and Country 2.

which is defined as the proportion of transport cost in the delivered price of the manufactured goods ($0 \leq f \leq 1$). The value of *f* equals unity when transport cost is zero, and it approaches zero as transport cost becomes infinitely large. These figures are drawn by assuming that the freeness of the transport between ROW and each of Countries 1 and 2, *f'*, is lower than that of trade within the integration ($f' < f \leq 1$).

The left panel (a) of Figure 7 depicts the case where the three countries are endowed with identical quantities of labor and capital. When transport cost within the integrated economy is as low as transport cost in the trade with ROW (i.e., *f*=*f'*), the three countries are situated in completely the same conditions, and thus in equilibrium. They have the same share of manufacturing industry, $s_n^1 = s_n^2 = s_n^{ROW} = 1/3$. As the freeness, *f*, increases in the process of economic integration, an increasing number of manufacturing firms relocate from ROW to Countries 1 and 2 because the transport facilitation within the integrated economy makes ROW relatively isolated and less attractive to the global capital. Yet, the shares for Countries 1 and 2 are always equal as they have identical conditions. In this case, therefore, integration does not intensify the disparity between the integrated countries.

In contrast, if there is a large difference in factor endowment, integration may intensify the disparity between the integrated countries. The right panel (b) of Figure 7 shows a case where Country 1 is much smaller in factor endowment than Countries 2, while keeping all other assumptions the same as the symmetric case of panel (*a*). As integration progresses (*f* increases), the smaller country in the integrated economy, Country 1, loses its share of manufacture. This is because the home market effect works between Countries 1 and 2. Eventually, when *f* =1, all firms are agglomerated in Country 2. In cases where diversified countries with different endowment are forming

Figure 7: Transport Cost and Production Shares.



(a) Symmetric case (b) Highly asymmetric case

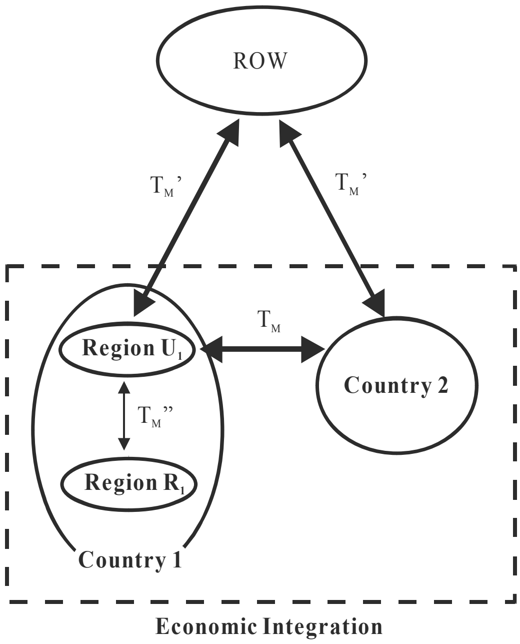
Source: Nishikimi (2007).

integration, the economic disparity may expand as trade liberalization progresses in the process of integration.

3.2.3 Disparity among domestic regions

Nishikimi (2007) also examines how integration of countries affects the disparity among domestic regions within each country. To do this, the preceding model is revised in as much as Country 1 is assumed to compose of two regions, U_1 and R_1, as shown in Figure 8. It is assumed that all international ports in Country 1 locate in U_1, while R_1 is situated in deep inland. Domestic transport of the manufactured goods also incurs costs, and, as in the previous model, capital is freely mobile across countries and regions, while labor is mobile only within each country.

Figure 8: Three-country, Two-region Model.



Source: Nishikimi (2007).

Nishikimi (2007) shows that a decrease in transport cost accompanying the process of integration accelerates localization of the IRS manufacturing industry in urban area, U_1. This is because market integration provides larger opportunities to Region U_1, which possesses the advantage of better accessibility to the integrated market than Region R_1. As a result, economic integration tends to intensify the economic disparity among domestic regions, U_1 and R_1.

4. DEVELOPMENT STRATEGIES UNDER ECONOMIC INTEGRATION: POLICY IMPLICATIONS

Based on the discussions in the preceding sections about several effects of economic integration, we now investigate possible development strategies for countries where economic integration is ongoing.

If the dispersion forces alone are at work in the process of integration, it would be rather easy to design a strategy. Every country can achieve an efficient resource allocation by fully utilizing market mechanism. In this case, all we need are liberalization and facilitation of trade for the market to work smoothly. However, the dispersion force does not seem to dominate in recent East Asia -- the flying geese pattern of industrialization is no longer clearly observed, and a growing number of industrial agglomerations have been emerging in various areas of the region. The agglomeration force appears to exert significant influences upon the industrial development in this area.

Under the influence of the agglomeration force, a small difference in the initial state may be amplified throughout the development path while a huge difference may be seen in the consequence. In this sense, individual development policies can trigger a long-term prosperity in economic development, but at the same time can entail a considerable risk of policy failure, which may cause long-term problems in development performance.

4.1 Transport costs and economic development

4.1.1 Transport development and lock-in effects

In Section 3.1.2, we have seen how the home market effect encourages growth of existing agglomeration and hinders birth of new clusters. This often brings a result where once a geographical structure of industrial agglomeration appears, it tends to be preserved even if that structure is not efficient. This tendency is regularly referred as *lock-in effect* of agglomeration.

More importantly, as transport cost and tariff/nontariff trade barriers are lowered, competition among industrial agglomerations becomes severer, and this poses tough conditions to infant clusters. In other words, the lock-in effect becomes more prominent as economic integration progresses. Therefore, each country can hardly foster clusters by merely promoting economic integration. Each integrated country needs to build up its own strategy to attract industrial firms, in competition with all other surrounding neighbors.

While the agglomeration force causes the lock-in effect, it can fuel the development of a new cluster if the government successfully attracts a critical mass of producers to a production site by implementing an appropriate policy, as illustrated in Figure 4. In this sense, integrated countries should try to design their strategies so as to utilize the agglomeration forces rather than to suppress them.

4.1.2 Development of transport hub

As discussed above, a decrease in transport cost alone is likely to discourage creation of new agglomerations in less industrialized countries. However, this will not occur if the decrease in transport cost is accompanied by formation of a transport hub. As discussed earlier, a reciprocal reinforcement mechanism works between development of transport hub and formation of industrial agglomeration, once the transport volume at the hub exceeds a critical level. Hence, if the government of a country succeeds to develop a transport hub up to a proper size, then the development of the hub and the cluster will be accelerated spontaneously by that mechanism.

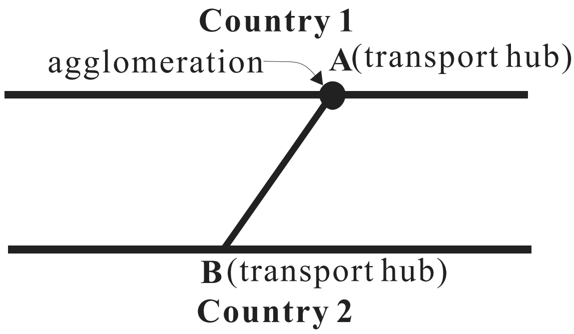
In Laos, for example, Vientiane has a good geographical advantage for its proximity to large cities in the surrounding countries such as Bangkok, Chiangmai, Hanoi, and Kunming. So as to exploit this advantage, the government needs to build a transport network connecting all the above cities and, at the same time, to stimulate industrial production in Vientiane. It should be noted that at this stage of development, the industrial production does not necessarily bring about the home market effect. It has only to create substantial demand for transport of the products and materials along the newly developed network. For emerging economies with small domestic markets, in particular, it seems feasible to start with fostering CRS industries such as foods, garments, and wooden products, rather than IRS industries such as chemicals, machinery, and electronics. They will be able to upgrade industries consecutively after establishing a transport hub, which connects and integrates several nearby markets.

The above strategy of industry-upgrade together with hub development appears to be applicable to other countries, too. For example, in Cambodia, a growing number of garment producers have recently operated in Phnom Penh, attracted mainly by cheap local labor. If the Cambodian government can successfully provide the appropriate transport infrastructure, its priority industry will bring about significant demand for transport to various cities, including Bangkok, Ho Chi Minh, and Sihanoukville for export by sea. Then, this will allow Phnom Penh to be a transport hub and enjoy the special location advantages in attracting IRS industries, which are generally accompanied by the agglomeration force and the lock-in effect in industrial localization. This development strategy with consecutive industry-upgrading seems steadier and more feasible than the strategy to form an agglomeration of IRS industries at one stroke by developing a special economic zone.

4.1.3 Control on transport costs

Another policy implication of the spatial economic arguments is the possibility of industrialization by manipulating trade/transport costs. Fujita and Mori (1996) examine the evolution pattern of industrial agglomeration, assuming the location space depicted in Figure 9. The integrated economy consists of two countries, which are connected only by one link (highway or sea route) between two transport hubs, *A* and *B*. In the initial state, a single agglomeration exists at *A*, the hub in Country 1.

Figure 9: Location Space.



Source: Drawn by author based on Fujita and Mori (1996).

Figure 10 shows the typical evolution pattern of agglomeration formation in this two-country economy.[12] In the figure, the horizontal axis represents the cost required for transport of the IRS product between the hubs,[13] while the vertical axis represents the total size of the integrated economy (total labor endowment). When the economy is sufficiently small, only the initial agglomeration can continuously exist in this integrated economy, no matter how much the transport costs. As the economy becomes large, a new agglomeration emerges in either country. If the international transport cost is sufficiently large, the new cluster appears in Country 1. In contrast, when the trade

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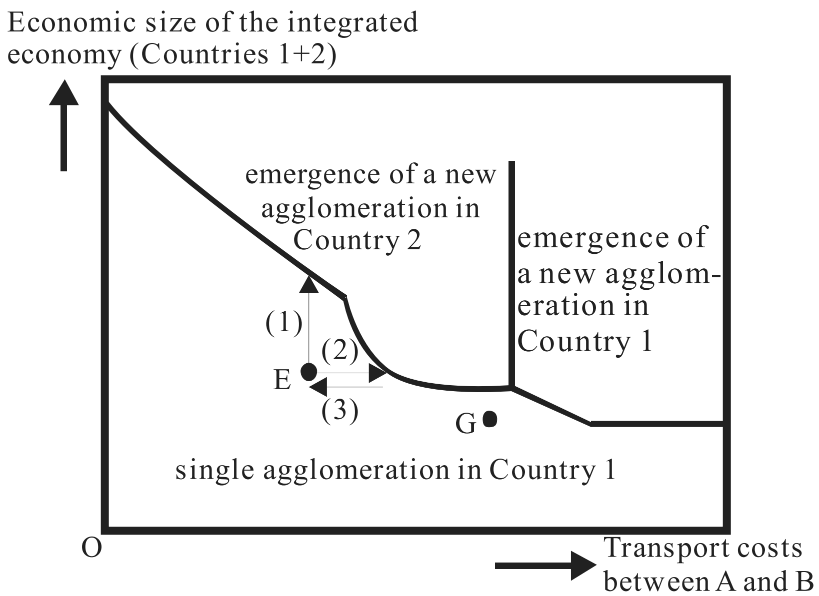
[12] Figure 10 is drawn for the case where labor is freely mobile across countries. In this case, the equilibrium level of consumers' utility (real wage) is equalized between the two countries. If we allow for international difference in the real wage, we can obtain a similar result to Figure 10 for the cases with restrictive labor mobility, too.

[13] We assume that transport of CRS products does not entail any cost.

cost is small, the new cluster appears in Country 2 although it requires a relatively large market because of the strong lock-in effect created by the first cluster.

Now, suppose that the current state of the economy is given by Point *E* in Figure 10. What policy can the government of Country 2 exert so as to establish a new industrial cluster in Country 2? One possible choice is the *laissez-faire* policy: i.e., just wait for a sufficient growth of the integrated market without enforcing any active policy, as indicated by the arrow (1) in Figure 10. If regional integration expands the market enough to overcome the lock-in effect of the existent cluster, Country 2 will obtain a new cluster. If not, it may require a long time to foster the market.

Figure 10: Bifurcation Pattern and Alternative Transport Policies.



Source: Drawn by author based on Fujita and Mori (1996).

There is such an alternative policy measure as represented by the arrows (2) and (3). That is, the government can foster a new cluster by increasing the international trade cost by means of tariff and nontariff barriers [arrow (2)]. Then, once the new cluster is established in Country 2, it creates the lock-in effect and can remain at the same place even if the government replaces the policy and lowers the trade cost to the previous level [arrow (3)]. In other words, the government of Country 2 can set up a new cluster by a temporary restriction of international trade, utilizing the lock-in effect. This policy measure sometimes works effectively, especially in cases where infant industries need to be nurtured.

The above arguments suggest that a temporary policy intervention may affect the entire path of economic growth. If the government can manipulate such policy measures accurately according to circumstances, it may be able to achieve the optimal development by carefully choosing the growth path. However, it should be noted here that those policies involve formidable risks of failure. For example, in Figure 10, suppose that the initial state of the integrated economy is represented by Point *G*, instead of Point *E*. In this case, the above policy of increasing the trade cost will lead to the emergence of a new cluster in Country 1 instead of Country 2. This leads economic disparity between the two countries to intensify, which is just the opposite of what is expected. As a matter of fact, it is quite difficult to identify correctly whether the economy is at Point *E* or *G*. Identical policies in similar situations can lead to completely different results. Halfhearted policymaking with superficial information may lead to negative results. Moreover, we have to remember that under the dominance of the agglomeration force, a temporary failure can affect the entire path to economic development.

4.2 Competition in public investment

4.2.1 Excess investment for agglomeration-luring

As discussed in the preceding sections, long-run industrialization and economic development may be triggered by the success of a short-run program for firm attraction, particularly at the initial stage of agglomeration development. Therefore, the governments of many countries are eager to construct special economic zones (SEZ) and huge international ports/airports, spending large amount of public funds and economic assistances from abroad. This leads to an international competition in luring agglomeration, but unfortunately, not all of the investments can be rewarded because of the limited market size in developing countries.

Figure 10 above shows that when the market is relatively small, only a single cluster can be sustained in the entire area of the integrated countries. A similar situation can also be demonstrated by Figure 11. This figure depicts the home market effect of the clustering industry by revising Figure 4 for the case where market demand in the integrated economy is so small, as given by Q_F in Figure 11. In this case, there are three equilibria of which the dispersive equilibrium G is unstable, unlike the case of Figure 4. Thus, if two countries compete in investment to attract agglomeration, either of them has to abandon its development plan. As a result, a large amount of investment will be wasted.[14] That is, without any coordination among governments, severe competition among neighboring countries will lead to excess investment for agglomeration-luring.

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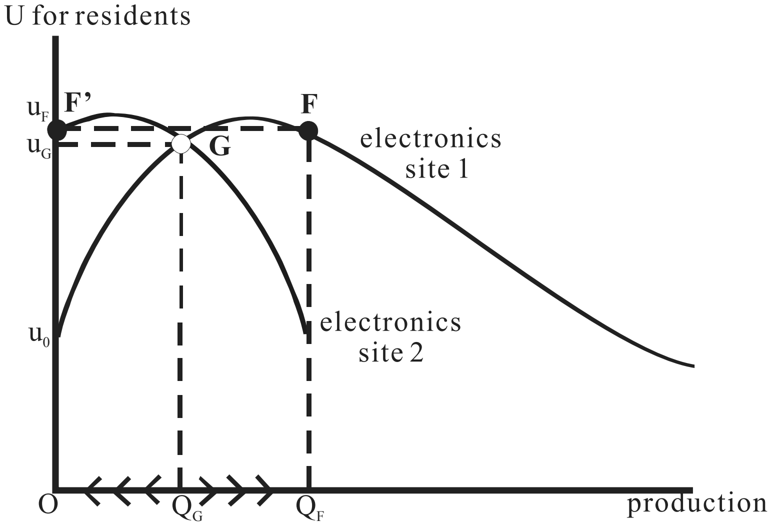
[14] The government can avoid the passing of agglomeration by enforcing protectionist policies, but it will be accompanied by large costs of misallocated resources.

Figure 11: Prisoner's Dilemma in Development Policy.



Source: author.

4.2.2 Benefits and risks of policy coordination

The agglomeration-luring activities by adjacent countries have a game structure that is of the prisoners' dilemma type, and this is the main cause of the excess investments devoted to industrial agglomeration.

At the initial stage, many neighboring countries have an equal opportunity to obtain a new industrial cluster, and the cluster may be set up by a short-run policy, as discussed previously. In such a situation, it is rather natural for governments of those countries to eagerly invest in cluster-building. To avoid the redundant investment by neighboring countries, those countries need to coordinate their policies in this aspect. For example, the number and location of international airports should be determined in cooperation with neighboring countries, so that the countries can efficiently share the optimal number of airports. Otherwise, each country may try to construct an international airport for its own use, and this is clearly an over-investment. Similar problems can occur in the construction of SEZs for large-scale agglomerations, such as that on automobiles, electronics, and heavy chemicals.[15]

Policy coordination, however, is not a panacea for the efficient resource allocation in agglomeration-luring. It may produce a serious side effect: Coordination can easily shift to collusion. If geographical distribution of clustering industries is determined by negotiation in the intergovernment assembly, then those industries are likely to be separated from market competition. This would make the industries spoiled and cause serious inefficiency in resource allocation. Of course, inefficient producers cannot survive the market competition, and the industrialization may fail in the long run. We are thus placed in a dilemma over what development strategy can be applied and need to look for a better way of allocating investment.

5. CONCLUDING REMARKS

In this chapter, we have examined two forces, dispersion and agglomeration forces, which are brought about by economic integration. These two forces bring different effects on resource allocation in integrated countries. In cases without scale economies, the dispersion force determines industrial location according to each country's comparative advantage, and a competitive equilibrium achieves a Parato optimal allocation. In contrast, if scale economies are at work, the agglomeration force serves as a dynamic source of industrialization and rapid economic development. However, this force tends to bring about inefficiency in static allocation of resources, and it may also produce serious economic disparities among integrated countries as well as among domestic regions within each country.

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[15] An effective coordination must be accompanied with some programs to compensate the devolving countries for forgoing benefits of the abandoned facilities, such as international airports and SEZs. It is not easy to design such a compensation program. In practice, this causes difficulty in coordination.

If the dispersion forces alone are at work in the process of integration, all we need are liberalization and facilitation of trade, so as to make the market work smoothly. However, the dispersion force does not seem to dominate in recent East Asia; the flying geese pattern of industrialization is no longer clearly observed, and a growing number of industrial agglomerations have been emerging in various areas of East Asia. The agglomeration force appears to exert significant influences upon the industrial development in this area.

In this situation, what kind of development strategy should be drafted for CLMV countries, so as to catch up? Is it the one that weakens the agglomeration force? –The answer here is No, such a strategy is neither effective nor realistic. Instead, we should try to utilize the agglomeration force aggressively to attract productive industries. To do this, it is important to manage dexterously various nonlinear effects, such as the home market effect, lock-in effect and hub effect, which are all likely to accompany economic integration.

Under the agglomeration force, a long-run industrialization and economic development can be triggered by the success of a short-run program to invite firms at the initial stage of the agglomeration development. However, there are two kinds of difficulties in implementing a successful strategy: (1) difficulty of the government to collect accurate information about the current state of the country, and (2) difficulty in policy coordination among the integrated countries. We should overcome these difficulties, taking into account the actual situation surrounding the country concerned.

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Chapter 3

CLMV DEVELOPMENT ASSISTANCE PROGRAMMES: BACKGROUND, APPROACHES, CONCERNS

Quah Boon Huat

ABSTRACT
Cambodia, Laos, Myanmar, and Vietnam joined the Association of Southeast Asian Nations (ASEAN) just as economic integration was accelerating. Concerns about the development gap hindering integration led to the launching of the Initiative for ASEAN Integration (IAI) Work Plan. The results of a case study of a Work Plan project focusing on implementation aspects, however, raises concerns about whether Work Plan objectives are being realized because of effectiveness issues. This paper concludes by recommending some implementation measures, widening the scope of the Work Plan, incorporating the programme into other existing development assistance frameworks, as well as expanding it into a wider regional initiative for East Asian integration.

1. INTRODUCTION

Rising regionalism in the other parts of the world as well as increasing competition from the regional giants China and India spurred ASEAN efforts at economic integration in the early 1990s. These integration efforts accelerated especially after the admission to ASEAN of the CLMV countries, namely Cambodia, Laos, Myanmar, and Vietnam. For ASEAN economic integration to proceed smoothly and effectively, however, there is a need to narrow the existing development gap between the older ASEAN-6 and the newer members.

The six-year IAI Work Plan was formulated and launched in 2002 with 48 projects to specifically target the development gap. The IAI Work Plan's programmes, activities and projects are directed at strengthening the CLMV countries' capacity, capability and resolve to meet the challenges ahead. Various issues and problems with the Work Plan were documented in the Mid-Term Review report where several recommendations were made.

This paper looks at some implementation, evaluation, and assessment aspects of a specific Work Plan project and then infers from the evidence gathered whether the aims of the IAI Work Plan are being met. It starts with a very short background introduction to the formation of ASEAN in Section 2. Section 3 describes ASEAN economic cooperation and integration, while the all-important issue of the development gap between ASEAN-6 and the newer members is described in Section 4. Section 5 looks at international initiatives to assist the CLMV countries, and Section 6 talks about what the IAI Work Plan is all about. A case study focusing on the implementation and evaluation aspects of a Work Plan project is discussed in Section 7. Section 8 concludes with recommendations.

2. FORMATION OF ASEAN

On August 8, 1967, five Southeast Asian countries comprising of Indonesia, Malaysia, the Philippines, Singapore, and Thailand formed the Association of Southeast Asian Nations. This was mainly a response to the then fluid regional political situation, though one of the aims of the association was to function as a regional association for economic, social, and cultural cooperation.

The founding of ASEAN was quite an achievement, considering the still tense regional political dynamics. There was the still recent 1963 military standoff between

Indonesia and Malaysia over the formation of Malaysia. There was also the failed merger attempt between Malaysia and Singapore, both countries going their separate ways in 1965 because of distrust and ideological differences. Add to the list of regional problems the Philippines' claim on Sabah, then already a part of Malaysia.

The document upon which ASEAN was founded—the "Bangkok Declaration"—was just a simple declaration of intent. It was signed as a display of solidarity against communist expansionism and insurgencies, i.e., the "common problems among countries of Southeast Asia," as well as to also emphasize the grouping's determination "to ensure their stability and security from external interference in any form or manifestation."[1]

The comments by former Indonesian Foreign Minister Ali Alatas that "the truth is that politics attended ASEAN at its birth" and that "it was the convergence in political outlook among the five original Members, their shared convictions on national priority objectives and on how best to secure these objectives in the evolving strategic environment of East Asia, which impelled them to form ASEAN " very nicely sums up the situation prevailing then.[2]

ASEAN spent its early years "fostering an atmosphere of trust and goodwill in which the Member Countries developed a habit of working together in informality and candor."[3] Building on the principles advocated in the founding document, the Declaration on Zone of Peace, Freedom, and Neutrality (November 1971) declared that the five founding nations "are determined to exert initially necessary efforts to secure

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[1] ASEAN Secretariat. "*The Bangkok Declaration, 1967.*" <http://www.aseansec.org/1212.htm>

[2] ASEAN Secretariat. *"Political Achievement."* <http://www.aseansec.org/11833.htm>

[3] *ibid.*

the recognition of, and respect for, South East Asia as a Zone of Peace, Freedom and Neutrality, free from any form or manner of interference by outside Powers."[4]

In 1976, the ASEAN Secretariat was established to improve coordination among ASEAN members. In the same year, the grouping's first formal agreement, the Treaty of Amity and Cooperation, which enshrined one of ASEAN's fundamental principles—that of non-interference—was signed.

Brunei joined ASEAN immediately upon achieving its independence from the United Kingdom in 1984. Vietnam was admitted in 1995, even though it was still under a communist system. Laos and Myanmar followed in 1997, and Cambodia in 1999.

ASEAN thus sought to stabilize the region politically in its early days. The grouping may have started out as a geo-political organization, set up in response to the fluid regional political situation at that time, but group dynamics veered towards economic cooperation during the 1970s, and later towards economic integration, especially from the 1990s onwards.

3. ECONOMIC COOPERATION AND INTEGRATION

At the Fourth ASEAN Ministerial Meeting in March 1971, suggestions of ASEAN economic integration by the Philippines' then-president Marcos was largely ignored.[5]

Five years later, at the First ASEAN Summit in Bali in February 1976, economic cooperation, not economic integration, moved onto the ASEAN agenda. The

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[4] ASEAN Secretariat. *"Zone of Peace, Freedom and Neutrality Declaration, November 1971."* <http://www.aseansec.org/3629.htm>

[5] Severino, R.C. (2006) *Southeast Asia in Search of an ASEAN Community*. Institute of Southeast Asian Studies, Singapore, p.221.

Declaration of ASEAN Concord, which called for economic cooperative action by member states "in their national and regional development programmes, utilizing as far as possible the resources available in the ASEAN region to broaden the complementarity of their respective economies," was thus made in the hope that regional cooperation in large-scale industries in critical sectors could spur economic development via industrialization.[6]

The motivation for the ASEAN Preferential Trade Agreement of 1977 was again merely that of regional economic cooperation. It was to ensure that there were ready markets for the products of the ASEAN Industrial Projects as well as those of the Industrial Complementation Schemes, and the hope was that preferential trading arrangements "will act as a stimulus to the strengthening of national and ASEAN economic resilience and the development of the national economics of the Member States by expanding investment and production opportunities, trade, and foreign exchange earnings."[7]

It was globalization and growing economic regionalism elsewhere that forced ASEAN to take another look at its economic agenda. The member countries had realized that they needed "to coalesce to be competitive in today's world—to enlarge their markets, attract investments, cut costs, increase efficiency, improve productivity and thus generate jobs and raise people's incomes."[8] At the Fourth ASEAN Summit in 1992, member countries agreed to create the ASEAN Free Trade Area (AFTA), a step

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[6] ASEAN Secretariat. "*Declaration of ASEAN Concord, February 1976*." <http://www.aseansec.org/1216.htm>

[7] ASEAN Secretariat. "*Agreement On ASEAN Preferential Trading Arrangements Manila, 24 February 1977*." <http://www.aseansec.org/2348.htm>

[8] ASEAN Secretariat. "*Economic Integration*." <http://www.aseansec.org/13635.htm>

toward regional economic integration, in which tariff and non-tariff barriers to trade among the members would be reduced and eventually abolished.

However, ASEAN regional free trade alone was (and is) seen as inadequate for the regional grouping to be able to tap effectively into unprecedented opportunities as well as cope with challenges being unleashed by globalization, especially with the rise of China and India. In December 1997, ASEAN leaders resolved to build an economic community to increase the region's economic potential. This resolution was followed through when the ASEAN leaders agreed during the Ninth ASEAN Summit in October 2003 in Bali to establish an ASEAN Economic Community by 2020, the end-goal of regional economic integration.

4. THE DEVELOPMENT GAP

The CLMV countries started becoming members of ASEAN from the mid-1990s onwards, just about when ASEAN economic integration was accelerating. Before the admission of the CLMV countries into ASEAN, there had already existed economic disparities within and between the six older members. Economic disparity, perceived to be a hindrance to economic integration, grew larger within the enlarged grouping with the admission of the CLMV countries, raising concerns about difficulties arising out of a two-tiered ASEAN.

There are fears that the grouping may become irrelevant in the global economy if effective economic integration cannot take place because of the regional economic divide. The CLMV countries have also realized that they must progressively and steadily integrate their economies with those of the older members if they do not want to be left behind. Time is of the essence because the development divide may widen, making worse an already bad situation when the benefits arising out of globalization become even more unevenly distributed among the members of the grouping, and therefore making it more difficult for ASEAN members to move and advance together.

As such, ASEAN has resolved to assist its less developed newer members to achieve their economic potential, with a view to ensuring effective economic integration. This will in turn better equip ASEAN to face the increasingly stiff economic headwinds of global competition. In the process, the less developed members will also be able to reap the benefits of ASEAN's economic integration process more equally as compared to the more developed members, and therefore ensure that prosperity is shared among the grouping's more than 550 million inhabitants.[9]

The UNDP Human Development Index (HDI) measures and compares each country's average achievements in basic human development, and can be used to get a good feel of the development gap between ASEAN member countries. Based on three component sub-indices, namely life expectancy, education, and GDP, the HDI value of a country, which ranges from 0 to 1, shows the distance the country has to travel to reach the maximum possible value of 1.

The latest HDI rankings (UNDP: Human Development Report 2007/2008) put Singapore, Brunei, and Malaysia in the "high human development" category while the rest falls under "medium human development." ASEAN member countries falling within the "medium human development" category can be further roughly subdivided

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[9] ASEAN Secretariat. Remarks by H.E. Ong Keng Yong, Secretary-General of ASEAN at the Opening Ceremony of the Regional Workshop on "*Bridging Development Gaps in ASEAN: Key Challenges Towards the Realization of ASEAN Community*," Lao PDR, February 2007.
<http://www.aseansec.org/20599.htm>

into "upper," and "lower." Thus, based on the latest HDI rankings, ASEAN is actually a three-tiered regional grouping, rather than two-tiered.

Between 1995 and 2005, Vietnam's stellar economic performance saw it surpassing Indonesia in the HDI rankings. It managed to improve its HDI reading from 0.661 to 0.733, an increase of 0.072 (see Table 1). If we assume that Cambodia, Myanmar, and Laos, are able to improve their HDI readings by 0.072 between the years 2005-2015, i.e. similar to Vietnam's achievement between the years 1995-2005, and then also assume (unreasonably) that the HDI readings of the rest of the ASEAN countries remain stagnant at the levels achieved in 2005, these three countries will still not be able to catch up with the rest, not even with Vietnam.

Table 1: Human Development Index Trends.

HDI Rank (2005)	Country	HDI Values				
		1985	1990	1995	2000	2005
25	Singapore	0.786	0.823	0.862	..	0.922
30	Brunei	..	..	..	..	0.894
63	Malaysia	0.696	0.723	0.761	0.791	0.811
78	Thailand	0.680	0.717	0.751	0.775	0.781
90	Philippines	0.695	0.722	0.738	0.759	0.771
105	Vietnam	..	0.618	0.661	0.696	0.733
107	Indonesia	0.585	0.626	0.665	0.682	0.728
130	Laos	0.425	0.451	0.488	0.523	0.601
131	Cambodia	..	..	0.536	0.545	0.598
132	Myanmar	..	..	..	..	0.583

Source: UNDP, *Human Development Report – 2007/2008.*

The improvements expected to be achieved over the years up to 2015 by the less developed ASEAN countries, namely Cambodia, Myanmar, and Laos, seemed not enough to enable them to catch up with the more developed ones, notwithstanding the existence of many international development assistance programmes since the early

1990s, including ASEAN initiatives, to assist Mekong-delta countries. Even worse, given the possibility that benefits from globalization may become even more unevenly distributed among the disparate members of the grouping, ASEAN faces the grim prospect of a widening development gap in the three-tiered grouping.

The next section touches on three examples of development assistance initiatives that were put in place prior to the Asian Financial Crisis of 1997-1998 to assist CLMV countries.

5. CLMV-FOCUSED COOPERATION AND ASSISTANCE

With the end of the Cold War hostilities and the Cambodian civil war, as well as the launching of free market reforms in the CLMV countries in the late 1980s, the Mekong region countries started becoming the focus of international attention from the early 1990s onwards. There were, and still are, various international forums and cooperative efforts, using a variety of approaches, promoting economic development in the region.

Pre-Asian Financial Crisis (1997-1998) international initiatives include, among many others, the following:

1. The ADB-sponsored GMS Economic Cooperation Programme

   Since 1992, the countries of the Greater Mekong Subregion (GMS), i.e., Cambodia, Laos, Myanmar, Vietnam, Thailand, and the Yunnan Province of the People's Republic of China, had, with the support of international organizations, embarked on a programme of economic cooperation. The programme has so far managed to achieve results that are more tangible and carried more impact on regional cooperation. High priority subregional development projects include projects in transport, energy, telecommunications, environment, human resource development, tourism, trade, and agriculture. With the ADB taking an active role in facilitating greater private sector involvement, the private sector has become a significant player in the GMS programme.

2. Working Group on Economic Cooperation in Cambodia, Laos, and Myanmar

Formerly known as the Working Group on Economic Cooperation in Indochina and Myanmar, it was established in September 1994 under the umbrella of the ASEAN and Japanese economic ministers meeting (AEM-MITI). It targeted countries that were not regular ASEAN members—Laos, Cambodia, and Myanmar (and initially, Vietnam). The aims of the Working Group were "not only to promote the economic development of Cambodia, Laos, and Myanmar but also to promote economic growth of the Southeast Asian region as a whole by strengthening the economic linkages between these countries and the ASEAN countries."[10]

3. ASEAN Mekong Basin Development Cooperation (AMBDC)

Initiated by ASEAN, AMBDC's first ministerial meeting in 1996 was attended by 10 Southeast Asian countries and China. The objectives were: (i) to enhance economically sound and sustainable development of the Mekong Basin; (ii) to encourage a process of dialogue and common project identification which can result in firm economic partnerships for mutual benefit; and (iii) to strengthen the

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[10] ASEAN Secretariat. *"Policy Recommendation of the AEM-MITI's Working Group on Economic Cooperation in Cambodia, Laos, and Myanmar, Phnom Penh, August 1996."* <http://www.aseansec.org/7954.htm>

interconnections and economic linkages between the ASEAN member countries and the Mekong riparian countries.[11]

Efforts by ASEAN to help tackle development issues and challenges in the Mekong region were shelved temporarily during the 1997-1998 Asian Financial Crisis when the grouping's members had to focus on their own economic problems. But as Asia recovered from the Asian Financial Crisis, Mekong development moved back onto ASEAN's radar screen.

The admission of the CLMV countries into ASEAN against the backdrop of a rapidly changing socioeconomic global landscape heightened the sense of urgency within the grouping to take steps to ensure that the grouping can meet the challenges ahead. In the light of these developments, correcting the so-called "ASEAN divide" became a high priority. The development gap became an even more important issue when ASEAN leaders agreed to build an ASEAN Economic Community by 2020. To help the region counter fierce competition from rising economic giants China and India, ASEAN leaders later agreed to speed up the target date by five years to 2015.

There was a greater commitment toward assisting the CLMV countries to ensure that no one gets left behind, as solidarity would be affected if the divide were not filled. To help hasten the economic development of the CLMV countries and narrow the development gap between the newer members and the more developed ASEAN-6, ASEAN leaders agreed in November 2000 to launch the Initiative for ASEAN Integration (IAI).[12]

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[11] ASEAN Secretariat. *"Basic Framework of ASEAN- Mekong Basin Development Cooperation, Kuala Lumpur, June 1996."* <http://www.aseansec.org/2474.htm>

[12] Besides the usual technical and development cooperation programmes, another major component of ASEAN-6 assistance is the Special and Differential Treatment (SDT) notified in ASEAN agreements.

In the meantime, AMBDC resumed its activities when it held its second ministerial meeting in 2000. At its third ministerial meeting in October 2001, it was agreed that Japan and South Korea would be taken in as additional members. Projects related to infrastructure, trade and investment, agriculture, forestry and minerals, industry, tourism, HRD, and science and technology have been implemented or are ongoing but financing problems hindered progress.

At the Eighth Ministerial Meeting of the AMBDC in August 2006, it was agreed to recommend that the AMBDC Ministerial Meeting be placed under the ASEAN Economic Ministers Meeting process at the 12th ASEAN Summit in December of the same year. The rationale given for the recommendation was that it would be easier to synchronize the economic integration activities, and hence make maximum use of resources available.[13]

6. THE INITIATIVE FOR ASEAN INTEGRATION (IAI)

Integrating the transitional economies of the CLMV countries with those of the older ASEAN members will be one of the regional grouping's greatest challenges. To give direction to and to sharpen the focus of ASEAN's collective efforts to narrow the development gap between it's older and newer members and ultimately enhance the grouping's competitiveness, ASEAN leaders agreed in November 2000 to launch the

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SDT allows the CLMV countries a longer period of implementation of liberalization policies or easier access to the markets of the ASEAN-6.

[13] ASEAN Secretariat. *"Joint Media Statement at The Eighth Ministerial Meeting of the ASEAN-Mekong Basin Development Cooperation (AMBDC), Aug. 2006, Kuala Lumpur."* <http://www.aseansec.org/18845.htm>

Initiative for ASEAN Integration (IAI) programme.[14] A six-year IAI Work Plan (July 2002–June 2008) was formulated and launched in August 2002 at the IAI Development Cooperation Forum in Jakarta.

The IAI Work Plan's programmes, activities, and projects are directed at strengthening the CLMV countries' capacity, capability, and resolve to meet the challenges ahead. It will also prepare them to face global competition. Growth in productive capacities in the CLMV countries is being hindered by weak human resource capabilities as well as weak or absent policies, institutional, and legal frameworks. These factors also hinder the effective optimum use of foreign aid. ASEAN-6 contributes toward the IAI Work Plan by providing training, technical experts and equipment, among others.

Eleven Dialogue Partner countries and international development agencies have also supported the Work Plan projects by providing funding assistance. For example, Japan, under the ASEAN-Japan Plan of Action, will strengthen support for the realization of the IAI Work Plan and other regional and subregional endeavors to narrow the development gaps in ASEAN.[15]

The objectives of the IAI Work Plan are to:

1. Facilitate the development of policy, institutional, and regulatory frameworks; and,
2. Strengthening the capacity of the CLMV countries to:
   - Reduce poverty and increase standard of living; and
   - Improve civil service for global competition.

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[14] Under the Vientiane Action Plan, the IAI was broadened to include development efforts to narrow development gaps between sub-regions within ASEAN-6 itself. This paper focuses only on aspects of the development efforts associated with CLMV countries.

[15] ASEAN Secretariat. "*The ASEAN-Japan Plan of Action*." <http://www.aseansec.org/15502.htm>

The four priority areas of the current IAI Work Plan are: i) infrastructure development; ii) human resource development; iii) information and communication technology; and, iv) the promotion of regional economic integration. Three new focus areas were added after a Mid-Term Review of the IAI Work Plan, which was completed in November 2005. The Mid-Term Review recommended the broadening of the scope of the Work Plan to include tourism, poverty and quality of life, and projects of general coverage.[16]

The Report on the Mid-Term Review of the IAI Work Plan also pointed out issues of concern such as: i) weak inter-agency coordination, reporting mechanisms, implementation and follow-through actions; ii) the need to strengthen the ownership of the IAI projects by the CLMV countries; and iii) the level of coherence of the training programmes and duration of training courses, and unsatisfactory level of English proficiency among some instructors and trainees.

The following section focuses mainly on aspects associated with the implementation of IAI Work Plan projects and raises questions about project effectiveness.

7. CASE STUDY OF AN IAI WORK PLAN PROJECT

The table below lists a sample of completed IAI Work Plan projects:[17]

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[16] ASEAN Secretariat. "*Report on the Mid Term Review of the Initiative for ASEAN Integration (IAI) Work Plan*." <http://www.aseansec.org/18201.htm>

[17] ASEAN Secretariat. "*Status Update on Progress of IAI Work Plan as of 1 September 2006*." < www.aseansec.org/iai_update.doc>

Table 2: Sample of Completed IAI Work Plan Projects.

No.	Component	Projects	Donors
1	HRD-Public Sector Capacity Building	Project by Brunei – Executive Development Programme for CLMV Senior Government Officers (27 Feb – 23 April 2006, 16 participants)	Brunei Darussalam
2	Regional Economic Integration -Customs	Project by Malaysia – Senior Level Customs Officer Study Tour to Malaysia - Customized for CLMV Customs Administrators (19 Sep - 1 Oct 2005, 20 Participants)	Malaysia
3	Infrastructure-Transport	Project by Indonesia – TRN/02/009 – Railways Training for CLMV Countries. (Consists of 5 training courses, 16 participants for each component. Component 1 and 2: 3-24 May 2004, Component 3 and 4: 7-28 March 2005, Component 5 will be held on 4-22 April 2005)	Indonesia & Japan-ASEAN General Exchange Fund (JAGEF)
4	HRD-Labour & Employment	Project by Singapore – SCD/LAB/03/013/IAI –Training programme on Curriculum Development for Technical Vocational Education and Training (Cambodia: 6-22 July 2004, Laos: 23 June - 3 July 2003, Myanmar: 11-27 May 2004, Viet Nam: 8-24 June 2004)	Singapore
5	ICT	Project by Thailand – ETF/EAS/04/004/IAI – Joint IAI Project on e-ASEAN: ASEAN e-Commerce Programme (17-21 Nov 2003)	Thailand
6	HRD-Labour & Employment	Project by Philippines – Capacity Building Training Programmes on Technical Vocational Education and Training for CLMV Countries (Activity 1 was held in Ho Chi Minh City, 2-20 Aug 2004 with 15 participants from CLMV: 4 from Cambodia, 4 from Laos, 4 from Myanmar, and 3 from Viet Nam. Activity 2 was held in Manila on 18-29 October 2004 for 16 participants).	Philippines & ASEAN Foundation (Japan-ASEAN Solidarity Fund)

Source: Status Update on Progress of IAI Work Plan as of 1 Sept. 2006.

7.1 Workshop for Training the Trainers on e-Commerce

This workshop, which comes under the ASEAN e-Commerce Programme, was implemented in November 2003.[18] The objectives of the workshop were to:

1. provide a broader understanding of e-Commerce and the emerging cyberspace market, as well as develop and manage an e-Commerce curriculum in the context of company, industry, and unlimited cyberspace;
2. develop managerial skills for running an effective e-Commerce and/or research-based e-commerce curriculum; and,
3. provide an understanding of e-commerce strategic direction for building cyber-based e-Commerce future applications and research for both academics and practitioners in the future.

The instruction methods included lectures, case studies, and on-line assignments. A student manual and a CD ROM developed in-house by the implementing agency (i.e., training agency) supplemented the college-level US textbook "Managing Information Technology in the E-Business Enterprise" used in the course.[19]

The workshop had two sessions a day, each running for two hours and 45 minutes. The first three days of the workshop covered 14 chapters of the textbook, while lectures on the fourth day covered the following two topics: "Evaluate e-Commerce Curriculum" and "Develop e-Commerce Research Guideline and Future Direction."

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[18] Ministry of Commerce, Thailand. "*Completion Report on IAI Work Plan Project: ASEAN e-Commerce Programme – Workshop for Training the Trainers on e-Commerce.*"
< http://thairegistration.com/thai/e-commerce/pdf/Completion%20Report.pdf>

[19] O'Brien, J.A. 2002. *Management information systems: managing information technology in the e-business enterprise* (5th Edition). McGraw-Hill: USA.

The morning of the last day of the workshop was spent on a field trip. The daily schedule of the 5-day workshop can be found in the Appendix.[20]

7.2 Implementation, evaluation, and impact assessment

7.2.1 Definition of capacity building or development

According to the UNDP, “capacity is the ability of individuals, institutions, and societies to perform functions, solve problems, and set and achieve objectives in a sustainable manner”…and…“capacity development is thereby the process through which individuals, organisations, and societies obtain, strengthen, and maintain the capabilities to set and achieve their own development objectives over time.”[21]

Based on the above definitions and in the context of IAI Work Plan projects, capacity building or development programmes should target both human and institutional capacities, as well as build both analytical and decision-making skills for sustainability purposes.

7.2.2 Concerns

A glance at the daily schedule of the one-week workshop is enough for one to conclude that the workshop was ineffectively run. Participants’ comments like “need more time to cover all material presented in the curriculum,” and, “time for this course is too short,” confirmed this.

Other concerns include the following:

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[20] The daily schedule appearing in the Appendix has been edited slightly for typographical errors, and to ensure brevity and conciseness.

[21] UNDP. “*Capacity Development*.” <http://www.capacity.undp.org/>

1. Evaluations on course content, effectiveness of lecturers, site visits, and staff ratings ranged from "good" to "great." However, the evaluation exercises did not provide indicators that could give an insight into whether workshop objectives were met.[22] The following evaluation aspects were left out: i) Learning, which measures knowledge acquired, skills improved, or attitudes changed; ii) Behaviour, which measures whether what is learnt is actually put into practice at work; and, iii) Results, which looks at whether the training had any effect at the level of the organization.[23]
2. The activities in this workshop basically remained at an awareness-raising level only, even though building analytical and decision-making skills had been part of the project's objectives. This is an important issue because analytical and decision-making capacities are necessary to ensure sustainability of organizational change. Without these capacities, the hoped-for change is unlikely to take place.
3. The workshop was a one-day event and not part of any long-term programme. Neither was there any follow-through action. To be effective, the programme should include a series of workshops that reflect the priorities of each of the participants' countries.

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[22] The results of these first level evaluation exercises may not be that valuable for the following reasons: i) an exciting but irrelevant workshop could be rated higher than a less exciting but better constructed and relevant one; ii) the responses might have reflected trainees' interactions with the trainer, not value of the workshop; and iii) the responses were probably superficial because there were no open questions.

[23] According to the IAI Work Unit in the ASEAN Secretariat, in a reply to emailed inquiries, "post evaluation forms and questionnaires are sometimes sent to the participants at their work address at a given interval". Malaysian project implementers interviewed for this paper say that they have not yet conducted post evaluations of any sort. For details on the important levels of training evaluation, see Kirkpatrick, Donald L. (1994) *Evaluating Training Programs. The Four Levels*. Berrett-Koehler Publishers, USA.

4. Building human capacities alone does not ensure that the process of organizational change is sustainable. Institutional capacities also need to be developed. Though the workshop implicitly had this as one of its objectives, there lacks follow-up activity to ensure that the project will lead to institutional capacity building.
5. Though ICT courses under the IAI Work Plan are being run by both Brunei and Malaysia, there were participants coming from both these countries. This raises the question of whether the right participants from the right countries were targeted.
6. The very intensive workshop lectures were based on a US college-level textbook "*Management Information Systems: Managing Information Technology in the E-Business Enterprise"* by James A. O'Brien. Judging from the intensive schedule of the workshop, it is doubtful that the participants were able to follow and benefit from the lectures.

Interviews with Malaysian project implementing agencies running IAI Work Plan projects in Malaysia confirmed that:

1. No training needs analyses were conducted. As such, there was no way for them to identify problems or other issues in the workplace. Training needs analysis is necessary to specifically define the gap between current and desired individual and organizational performances, and therefore determine whether training is an appropriate response or not.

2. They have no idea whether or not the participants were chosen based on the organizational needs of their institutions. One project implementing agent felt that some senior officials were monopolizing the opportunities to train overseas. [24]

3. Some participants had difficulties understanding the coursework conducted using the English language.

4. Except for the first level on-site evaluation exercises conducted at the end of the programmes, they were not mandated to measure the kind of knowledge acquired or skills improved.[25] Neither were they required to do second, third, or fourth level evaluations nor informed of the results of such evaluations, if such evaluations were indeed carried out, as to whether:[26]

   - trainees actually apply what they have learned in their workplace.
   - there are barriers preventing trainees from applying their learning in their workplace.
   - the training had resulted in changes in trainees' work performances, and if there had been changes, whether the changes had been substantial enough to affect organizational performances.

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[24] According to the IAI Work Unit, "while further guidance is provided by the trainers and the ASEAN Secretariat at the selection stage, final decisions as to the actual selection of participants are left to each of the participating Member Country." One Malaysian project implementer, however, commented that they were not consulted on the level and characteristics of the ideal candidates for participation in the workshops, seminars, etc.

[25] According to the IAI Work Unit, "evaluation often only extends to course participants and second hand information is not captured unless specifically shared by the respective line agency or Member Country."

[26] According to the IAI Work Unit, "…IAI Meetings, which occurs four times a year, provides an effective platform to allow for continuous feedback between all stakeholders…" Malaysian project implementers interviewed say that they were provided with feedback for reference in the design of future courses. The question that should be raised here is why the implementing agencies were left out of the training evaluations and assessments.

- the impacts on organizational performances emanating from the changes in trainees' work performances were sustainable.

The following section concludes and sets forth some recommendations.

8. CONCLUSION AND RECOMMENDATIONS

The CLMV countries started joining ASEAN at a time when economic integration was accelerating within the grouping. To ensure effective and smooth economic integration of the ASEAN-10, ASEAN launched the IAI Work Plan in 2002. The Work Plan aims to help narrow the development gap between the older ASEAN-6 member countries and the newer CLMV countries, as well as to strengthen the latter's capacity, capability and resolve to meet the challenges ahead.

The result of a case study on the implementation aspects of a specific Work Plan project, however, raises questions about the effectiveness of that particular project, and in turn raises concerns about whether the aims and objectives of all IAI Work Plan projects are being realized. These are serious concerns if the capacity building efforts of the IAI Work Plan, which is scheduled to end its six-year run in June 2008, have not contributed effectively towards narrowing the development gap between the ASEAN-6 and the CLMV countries. Or worse, the development gap has widened further despite the IAI Work Plan, a real possibility because benefits arising out of globalization may be becoming even more unevenly distributed among the disparate members of the grouping.

To help improve effectiveness and efficiency of development assistance, it should be emphasized that projects and programmes targeting less developed members should be drawn up separately to cater to each country's specific needs because of the differences in the pace of reforms and level of socioeconomic performance.

To facilitate this process, development assistance recipient countries should take ownership of their development problems and determine the final outcome of capacity building efforts because "capacity building … isn't a process where an organization external to the process can determine the final outcome."[27] To this end, a special unit should be set up in each of the CLMV countries, if they not already have, to carry out activities that should include:

1. conducting training needs analysis to identify problems or other issues in the workplace, and based on the results, work together with the implementing agencies in the ASEAN-6 to design relevant capacity building courses to target their specific training needs;
2. ensuring that the right trainees are sent to the right courses, and are actually able to apply what they have learned in their workplace; and
3. measuring changes in trainees' work performances, evaluate whether the changes have been substantial enough to affect organizational performances, as well as assess whether the impacts have been sustained.

Needless to say, the special unit should make the results of all post-evaluation and assessment activities available to the other stakeholders in the IAI Work Plan projects, especially the project implementers.

ASEAN needs help in its efforts to narrow the development gap. There are clearly problems with the effectiveness of the IAI Work Plan programmes, as can be inferred

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[27] Macadam, R., J. Drinan., N. Inall, N. and B. McKenzie. 2004. *Growing the capital of rural Australia – the task of capacity building*. < http://www.rirdc.gov.au/reports/HCC/04-034.pdf>

from the case study in this paper. The "Report on the Mid-Term Review of the Initiative for ASEAN Integration (IAI) Work Plan" cited many problems, among which are the low quality of some of the programmes, and the lack of coordination between ASEAN and other development frameworks in the Mekong Basin. For the IAI Work Plan to be meaningful, it should be incorporated into, for example, the better regarded ADB-sponsored GMS Economic Cooperation Programme, or for that matter, other development assistance programmes targeting CLMV countries. After all, ASEAN-6 does not have deep enough pockets to meaningfully fund IAI initiatives.

Infrastructure development, for example, is one of the priority areas of the current IAI Work Plan. However, the focus of IAI Work Plan projects is on soft infrastructure, "such as conducting training to build up capacity, assisting in developing policy, institutional, legal and regulatory frameworks, conducting feasibility studies, etc."[28] The GMS Economic Cooperation Programme, on the other hand, has a heavy emphasis on physical infrastructure development. Linking the IAI Work Plan's soft infrastructure capacity building efforts to the GMS Programme's physical infrastructure development projects will increase effectiveness because of the synergies created.

The "Report on the Mid-Term Review of the Initiative for ASEAN Integration Work Plan" recommended broadening the scope of the Work Plan to include, among others, tourism. The CLMV countries are culturally rich, and have a natural environment brimming with potential. As such, culture and ecotourism projects should especially receive more attention. However, again for reasons of meaningfulness and effectiveness, tourism-related IAI Work Plan projects should be linked to similar

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[28] ASEAN Secretariat. "*Bridging the Development Gap among Members of ASEAN*."
<http://www.aseansec.org/14683.htm>

projects under other development frameworks in the Mekong Basin. The ongoing Mekong Tourism Development Project (which comes under the GMS Economic Cooperation Programme), for example, has among its initiatives, a project to develop 16 pro-poor community-based tourism products. This is a superb opportunity to link IAI Work Plan projects with this project, as eradicating poverty is also a Work Plan priority.

The scope of the IAI Work Plan should also be further widened to include projects aimed at specifically providing an enabling environment to small, medium, and micro-enterprises (SMEs). SMEs play such an important role in the process of providing incomes and creating jobs. SME-related Work Plan soft infrastructure projects could, for example, target the elimination of bureaucracy and assist in the creation of efficient and reliable public administration systems, since bureaucratic hurdles are a special burden for SMEs. Institutions should also be set up to ensure easier credit access and training for SMEs, if they not already have.

Since the CLMV countries are still basically agriculture-based, non-agricultural economic activities provide vital earnings supplements for rural households. Work Plan projects could target especially non-agricultural SMEs that are closely tied to agriculture through demand and supply linkages. Needless to say, SMEs involved in cultural and eco-tourism activities should also be targeted.

Economic integration is a trend. Broader regional integration processes in East Asia have already started, and the region is actively progressing on a path toward greater regional cooperation. East Asian regional cooperation and integration will bring with it the types of concerns that ASEAN is presently grappling with. During the first East Asia Summit in December 2005, leaders from the 10 member states of ASEAN, China, Japan, South Korea, India, Australia, and New Zealand vowed to focus on, among other things, promoting cooperation in development, economic integration and growth, eradicating poverty and narrowing the development gap in East Asia, through technology transfer and infrastructure development, capacity building, good governance and humanitarian assistance.[29] These are the very issues ASEAN is currently focusing on in its community building efforts.

Economic disparities will likely become even more pronounced and therefore more of a concern in the context of East Asian regional integration. In anticipation of deepening East Asian regional cooperation and integration, ASEAN should thus see to it that the "Initiative for ASEAN Integration" is expanded into an "Initiative for East Asian Integration."

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[29] ASEAN Secretariat. "Kuala Lumpur Declaration on the East Asia Summit, Kuala Lumpur, 14 December 2005." <http://www.aseansec.org/18098.htm>

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APPENDIX

DAY 1 November 10, 17, 2003

8:30 - 9:00	Registration
9:00 - 9:30	Opening Ceremony
9:30 - 10:30	**FRAMEWORK FOR DEVELOPMENT AND ADMINSTRATION OF E- COMMERCE CURRICULUM**
10:30 - 10:45	Coffee Break
10:45 – 12:00	**PART I: UNDERSTANDING NATURE OF E-COMMERCE** MODULE I: FOUNDATION CONCEPTS Chapter 1: Foundation of e-Business (B2B, B2C, C2C, B2G, etc.) Chapter 2: Competing with Information Technology Case: McDonald's and American Express: E-Commerce Spin-off Strategies
12:00 -1:00	LUNCH BREAK
1:00 – 2:30	**PART II: CYBER SPACE ANALYSIS THROUGH WEB SITES** MODULE II: BUSINESS APPLICATIONS Chapter 3: The Internetworked E-Business Enterprise Case: Uniglobe.com and Allfirst Bank: Online Customer Care Alternatives Chapter 4: Electronic Business Systems Section I: Cross-Functional E-Business Systems Case 1: Siebel Systems and Telstra Corporation: Benefits of Customer Relationship Management Section II: Functional E-Business Systems Case 2: Alcoa and Cisco Systems: Real-time Manufacturing and Supply Chain Management
2:30 - 2:45	Coffee Break
2:45 – 4:00	Chapter 5: Electronic Commerce Systems Section I: Electronic Commerce Fundamentals Case 1: eBay Inc. and Amazon.com: Lessons from and E-Commerce Leader Section II: E-Commerce Applications and Issues Case 2: MarthaStewart.com: Building and E-Commerce Website Chapter 6: E-Business Decision Support Section I: Decision Support in E-Business Case 1: Siemaens AG: The Business Case for Global Knowledge Management Section II: Artificial Intelligence Technologies in Business Case 2: RivalWatch.com and Others: AI Tools for Competitive Business Intelligence
4:00 – 4:30	Questions and Answers. Class Adjourn.

Completion Report on ASEAN e-Commerce Programme

DAY 2 November 11, 18, 2003

8:30 - 9:00 Registration

9:00-10:30 **PART III: DEVELOP E-COMMERCE STRATEGIES**

MODULE III: DEVELOPMENT PROCESS

Chapter 7: Developing E-Business Strategies

Section I: E-Business Planning Fundamentals

Six major e-Commerce sectors strategies:

1. Infrastructure
2. Applications
3. Portals
4. Content
5. Services
6. Exchanges

Case 1: Accel Partners: The Past, Present, and Future of E-Commerce

10:30-10:45 Coffee Break

10:45-12:00 Section II: Implementing E-Business Strategies

Seven key to e-tailing success factors:

1. Selection and value
2. Performance and service efficiency
3. Look and feel of the site
4. Advertising and incentives to purchase
5. Personal attention
6. Community relationships
7. Security and Reliability

Case 2: Cross Engineering, Pitney-Bowes, and Emerson: Change Management Challenges of CRM Systems

12:00-1:00 LUNCH BREAK

1:00-2:30 **PART IV: DEVELOP ACTION PLANS FOR E-COMMERCE DEVELOPMENT, IMPLEMENTATION, OPERATION**

Chapter 8: Developing E-Business Solutions

Section I: Developing E-Business Systems and Web-Store

Nine Essential e-commerce Processes:

1. Access control and security
2. Profiling and personalizing
3. Search management (yahoo.com, google.com, etc)
4. Content management
5. Catalog management
6. Payment (web-payment, EFT, digital wallet)
7. Workflow management
8. Event notification and Advertising
9. Collaboration and trading (customer, suppliers, stakeholders and employees)

2:30-2:45 Coffee Break

2:45-4:00 Section II: Implementing E-Business Systems

Case 3: The Sports Authority and Others: E-Commerce Website Design Requirements:

- Web site navigation
- Shopping cart design
- Checkout process
- Trust and security
- Web site speed

4:00 – 4:30 Questions and Answers.
Class Adjourn.

DAY 3 November 12, 19, 2003

8:30 - 9:00	Registration	
9:00-10:30	**PART V: INCLUDE E-COMMERCE SECURITY & PRIVACY, LAWS AND REGULATIONS**	
	MODULE IV: MANAGEMENT CHALLENGES	
	Chapter 9: Security and Ethical Challenges of E-Business	
	Section I:	Security, Ethical, and Societal Challenges of E-Business.
	Section II:	Security Management of E-Business: (1) Hacking, (2) Cyber theft, (3) Unauthorized use at work, (3) Software Piracy and Law, (5) Fraud and Ethics, and (6) Computer Audit
	Case:	e-Customs at Bangkok International Airport Customs Bureau, Bangkok, Thailand
10:30-10:45	Coffee Break	
10:45-12:00	Chapter 10: Enterprise and Global Management of E-Business Technology	
	Section I:	Managing E-Business Technologies: (1) e-Business and IT, (2) Managing IS Function, and (3) e-Business Technology Management
	Section II:	E-Business Technology Management: (1) Global e-Business Technology Management, (2) Cultural, Political and Geo-economic Challenges, (3) Global e-Business Strategies, (4) Global e-Business Application and Platforms, (5) Global Data Access Issues, (6) Global Systems Development
	Case:	UPS Thailand: e-tracking systems
12:00-1:00	LUNCH BREAK	
1:00 – 2:30	**PART VI: PREPARE E-COMMERCE INFRASTRUCTURE**	
	MODULE V: REVIEW OF e-COMMERCE TECHNOLOGIES Chapter 11: Computer Hardware for e-Commerce	
	Case 1:	BTG, NEC Electronics, and Biogen: The Business Case for Server Computer Farms
	Chapter 12: Computer Software for e-Commerce	
	Case 2:	TravelNow and BEA Systems: The Business Case for Application Servers
2:30-2:45	Coffee Break	
2:45-4:00	Chapter 13: Data Resource Management	
	Section I:	Managing Data Resources
		Case 1: Shop at Home and Others: Data Resource Management for Business Intelligence
	Section II:	Technical Foundations of Database Management
		Case 2: Payless Shoe Source: the Challenges of Storage Management
	Chapter 14: Telecommunication and Networks	
	Section I:	Overview of Telecommunication and Networks
		Case 1: Weblinc and others: The Business Case for Wireless LANs
	Section II:	Technical Telecommunications Alternatives
		Case 1: Piasecki Steel, Lguide.com and Cyber-Train: Evaluating Broadband Alternatives
4:00 – 4:30	Questions and Answers Class Adjourn.	

DAY 4 November 13, 20, 2003

8:30 - 9:00 Registration

9:00 – 10:30 **PART VII: EVALUATE E-COMMERCE CURRICULUM**

Section I: Framework for e-Commerce Teaching Evaluation (e-CTE)

1. Objectives of e-CTE
2. e-CTE Techniques
3. e-CTE Analysis and Administration
4. e-CTE during Teaching and Learning Process
5. Standard e-CTE
6. Strategy to Improve e-CTE Technique

10:30-10:45 Coffee Break

10:45-12:00 Section II: Enhancing E-Commerce Curriculum that Fit with Your Organization

12:00-1:00 LUNCH BREAK

1:00 – 2:30 **PART VIII: DEVELOP E-COMMERCE RESEARCH GUIDELINE AND FUTURE DIRECTION**

Section I: Guideline for development and administration of Research–based E-Commerce Curriculum:

1. Develop Research Questions
2. Conduct Relevant Literature Review
3. Develop Research Model or Framework
4. Select Research Methodology
5. Conduct Data Collection and Analysis
6. Conclusion and Major Findings

2:30 - 2:45 Coffee Break

2:45 – 4:00 Section II: Future Direction of E-Commerce and Research

1. Future Research Topics
2. Publication of Results
3. E-Business Research Club at NIDA

4:00 – 4:30 Questions and Answers

Class Adjourn.

DAY 5 November 14, 21, 2003

8:30 - 9:00	Registration
9:00 - 10:00	**PART IX: FIELD TRIP to:** **Phillip Securities (T) PCL** (for session starting on 10 Nov. 2003) **or** **Seagate (T) Co. Ltd.** (for session starting on 17 Nov. 2003)
10:00 - 10:15	Arrival at company
10:15 - 10: 45	Company briefing
10:45 - 11:00	Coffee Break
11:00 - 12:00	Company tour
12:00 - 2:00	Lunch
2:30 - 3:30	Back to training centre
3:30 – 4:30	**CERTIFICATE PRESENTATION CEREMONY/PARTY**
4:30	**CONGRATULATIONS!** Class Adjourn.

Chapter 4

GMS ECONOMIC COOPERATION AND ITS IMPACT ON CLMV DEVELOPMENT

Masami Ishida

ABSTRACT

Development in the Cambodia, Laos, Myanmar, Vietnam (CLMV countries) is impossible to discuss without mentioning the projects of the Greater Mekong Subregion Economic Cooperation Program (GMS-ECP). The GMS-ECP is an economic cooperation program inaugurated in 1992 by six countries, namely, Cambodia, Laos, Myanmar, Vietnam, Thailand, and Yunnan Province of China through the initiative of Asian Development Bank (ADB). In this chapter, the three stages of GMS-ECP history is reviewed. Then, the concept of GMS economic corridors, which include the cross-border transportation agreement (CBTA), is explained. Finally, the paper reviews the policies implemented so far on using geographical locations for developing the economic corridors. Thus, favorable policies are identified and analyzed.

1. INTRODUCTION

About fifteen years ago, the Greater Mekong Subregion Economic Cooperation Program (GMS-ECP) was inaugurated (1992). Since then, the regional economic cooperation of the six Member Countries of GMS region (e.g., Cambodia, China, Laos, Myanmar, Thailand and Vietnam) have expanded and deepened. 1992 was considered a symbolic year because the long wartime in Indochina was ended through the Paris Peace Agreement in the following year. Peace building was an initial, yet, important role expected from GMS-ECP. Its members formulated means to grow towards peace, through dialogues for economic cooperation among themselves.

Today, the GMS-ECP contributes in the regional integration of the East Asia through its free trade agreements. GMS-ECP designated the economic corridors within in the GMS region to facilitate increased cross-border trade and inland transportation among major cities in East Asia. Free trade movements, however, could widen regional gaps because they promote further agglomeration of the major cities.

On the other hand, Asian Development Bank (ADB) claims that one of the main purposes of the GMS-ECP is poverty reduction. The GMS-ECP is expected to play an important role in narrowing existing gap and reducing poverty while expanding and deepening the regional integration.

This chapter provides a review on the brief history of GMS-ECP and a description of the problems and prospects in realizing the economic corridors (ECS) of the GMS This discussion provides clarity on the possible means to reduce the regional gaps. Section one explains the project sectors involve and the decisionmaking system. The second section traces the three stages of the GMS-ECS. The third section describes the transfiguration from the transport corridors to the economic corridors, referring specifically to the additional economic activities and the development of soft infrastructure of the economic corridors.

2. THE FRAMEWORK OF THE GMS-ECP

The Greater Mekong Subregion Economic Cooperation Program (GMS-ECP) started with a Ministerial Meeting through ADB's initiative. Its Member Countries are Cambodia, Laos, Myanmar, Vietnam, Thailand and China. As for China, Yunnan

Province of China was initially considered as a member country of the program (ADB, 1993, p.1) but in 2005, Guangxi Zhuang Autonomous Region of China also became a member of the GMS-ECP.

GMS-ECP started with six development sectors, namely: transportation, telecommunication, energy, human resource, environment, and trade and investment. In 1994, tourism was added as a new development sector; trade and investment was separated in 1998; and, agriculture was included in 2001. Thus, it is now composed of nine sectors, namely: 1) Transportation; 2) Telecommunication; 3) Energy; 4) Human Resource; 5) Environment; 6) Trade; 7) Investment; 8) Tourism; and, 9) Agriculture.

After drawing the blueprint of potential projects in the region and the GME-ECP progressed into phases of implementation, Member Countries and ADB established the following sectoral working groups:

(a) GMS Subregional Transportation Forum (STF)

(b) Subregional Telecommunication Forum (STCF)

(c) Electric Power Forum (EPF)

(d) GMS Working Group on Human Resource Development (WGHRD)

(e) Subregional Working Group on Environment (WGE)

(f) GMS Business Forum (GMS-BF)

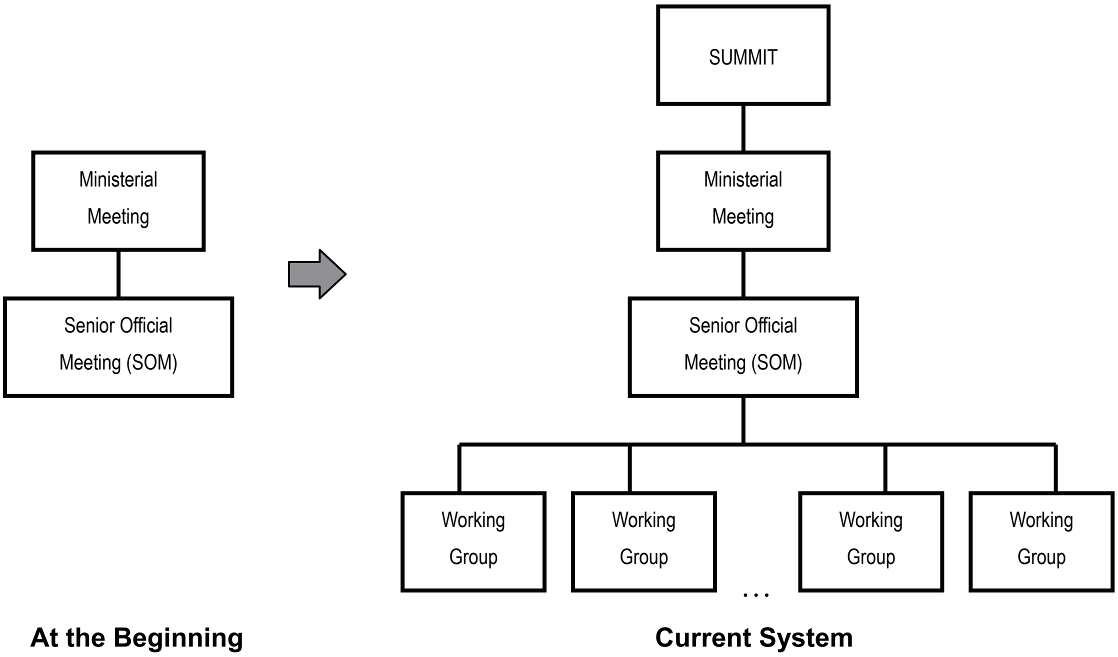
(g) Subregional Investment Working Group (SIWG)

(h) GMS Tourism Working Group (TWG)

(i) Working Group on Agriculture (AGA)

In terms of the decisionmaking system, GMS-ECP started with two layers process (left side of Figure 1) which were the senior official meeting (SOM) and Ministerial Meeting. When the working groups were established, layers increased into three. In

Figure 1: Change in Decisionmaking System of GMS-ECP.



Source: author.

2002, a custom of opening the GMS Summit started, consequently, the number of layers increased to four (right side of Figure 1). Aside from the technical and financial support, ADB also acted as a catalyst or an "honest broker," who encourages dialogues, provides the fora, and extends assistance when needed. The process only emphasized the fact that the Member Countries owns the GMS-ECP and not ADB, even if it had provided valuable assistance and resources.

3. BRIEF HISTORY OF GMS-ECP

The history of the GMS-ECP can be presented and understood easily by dividing its period into three stages; the first stage (1992-1996); the second stage (1994-2001); and, the third stage (2001- to present).

3.1 First Stage (1992-1996)

The first stage (1992-1996) was the period that involved two components, namely, the creation of GMS-ECS principles and the fact finding and project formation. The creation of principle component generated several important principles, which were declared at the First Ministerial Meeting in 1992. One of the most important principle is the "two plus" principle, wherein, projects of the GMS-ECP need to be subjected into any of these two conditions:

(a) each project involves, at least, two countries (purely subregional project), or,

(b) a national project that will benefit the whole region (national project with subregional dimension).

Construction of a bridge at the border of two countries is an example of the former. A national project on constructing and opening a new airport, however, is an example of the latter. It is important to note that GMS-ECP project does not require the unanimous agreement of six countries; it can start based on an agreement of any number of participating countries. The "two plus" principle brought about more projects focused on border areas, which were more likely regarded as periphery and a cross-border trade. Moreover, the role played by ADB as an "honest broker", utilizing, and improving existing infrastructure are also examples of other principles.

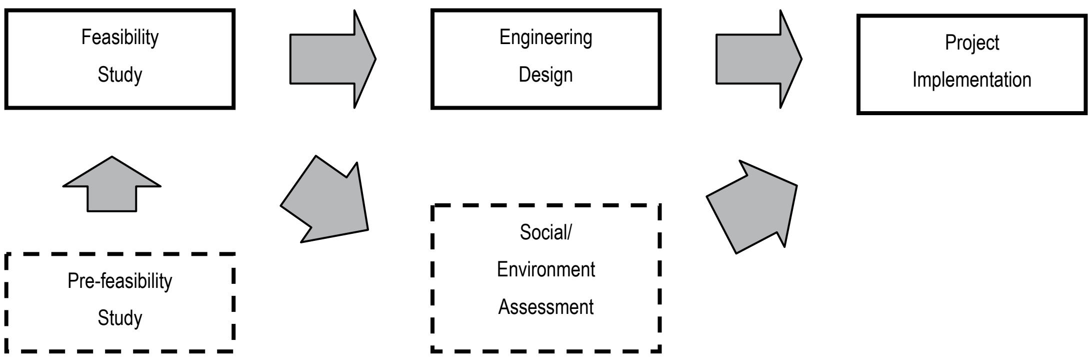
The second component of this stage is the fact finding and project formation. It involved the country visits of a study team, dialogues (exchange of views) on subregional cooperation, and the identification of projects to strengthen subregional economic cooperation. Thus, the Third Ministerial Meeting in 1994 finalized and approved the list of projects that later became the blueprint of the GMS-ECP.

3.2 Second Stage (1994-2001)

The second stage (1994-2000) is the implementation stage of the listed projects. One of the listed projects was the Yunnan Expressway between connecting Chunxiong and Dali; it was constructed soon after it was listed up. However, most of listed projects start with feasibility study and undergo engineering design prior its stage of implementation. In some cases, pre-feasibility studies were conducted before a full blown feasibility study. Social and environment impact assessments were conducted simultaneously with the engineering study (Figure 2).

In terms of project financing, it was clear that not all listed projects were to be funded by ADB. Some national projects, with subregional dimension, were financed out of the country's budget. Others are sponsored or cosponsored by ADB or by the other donors.

Figure 2: Processes for Implementing Listed Projects.



Source: author.

3.3. Third Stage (2001- to Present)

The third stage started on the tenth anniversary of the GMS-ECP in 2001. Being a memorable year, GMS-ECP started its 10-Year Strategic Program (2002-2011). Projects were categorized into 10 flagship programs with GMS tourism development as the eleventh flagship program in 2002.

1) North-South Economic Corridor
2) East-West Economic Corridor
3) Southern Economic corridor
4) Telecommunication Backbone and ICT
5) Regional Power Interconnection and Power Trade Agreements
6) Facilitating Cross-Border Trade and Investment
7) Enhancing Private Sector Participation and Skill Competencies
8) Developing Human Resources and Skill Competencies
9) Strategic Environment Framework
10) Flood Control and Water Resource Management
11) GMS Tourism Development

4. ECONOMIC CORRIDOR

4.1 Transportation Corridors

Transportation sector is considered to be the most important among the GMS-ECP sectors. As a matter of fact, ADB initially felt the necessities for rebuilding transport infrastructure that was badly damaged by almost forty years of conflicts. In the 1994 list of the projects, the nine cross-border transport infrastructure (CBTI) routes were designated as road improvement projects of the subregional priority projects (Figure 3).

R1. Bangkok-Phnom Penh-Ho Chi Minh City-Vung Tau Road Project

R2. Thailand-Lao PDR-Viet Nam East-West Corridors

R3. Chiang Rai-Kunming Road Improvement Project via Myanmar and Lao PDR

R4. Kunming-Lashio Road System Improvement Project

R5. Kunming-Hanoi Road Improvement Project

R6. Southern Lao PDR-Sihanoukville Road Improvement Project

R7. Lashio-Loilem-Kentung Road Improvement Project

R8. Southern Yunnan Province-Northern Thailand-Northern Lao PDR-Northern Viet Nam Road Improvement Project

R9. Northeastern Thailand-Southern Lao PDR-Northeastern Cambodia-Central Viet Nam Corridor Project

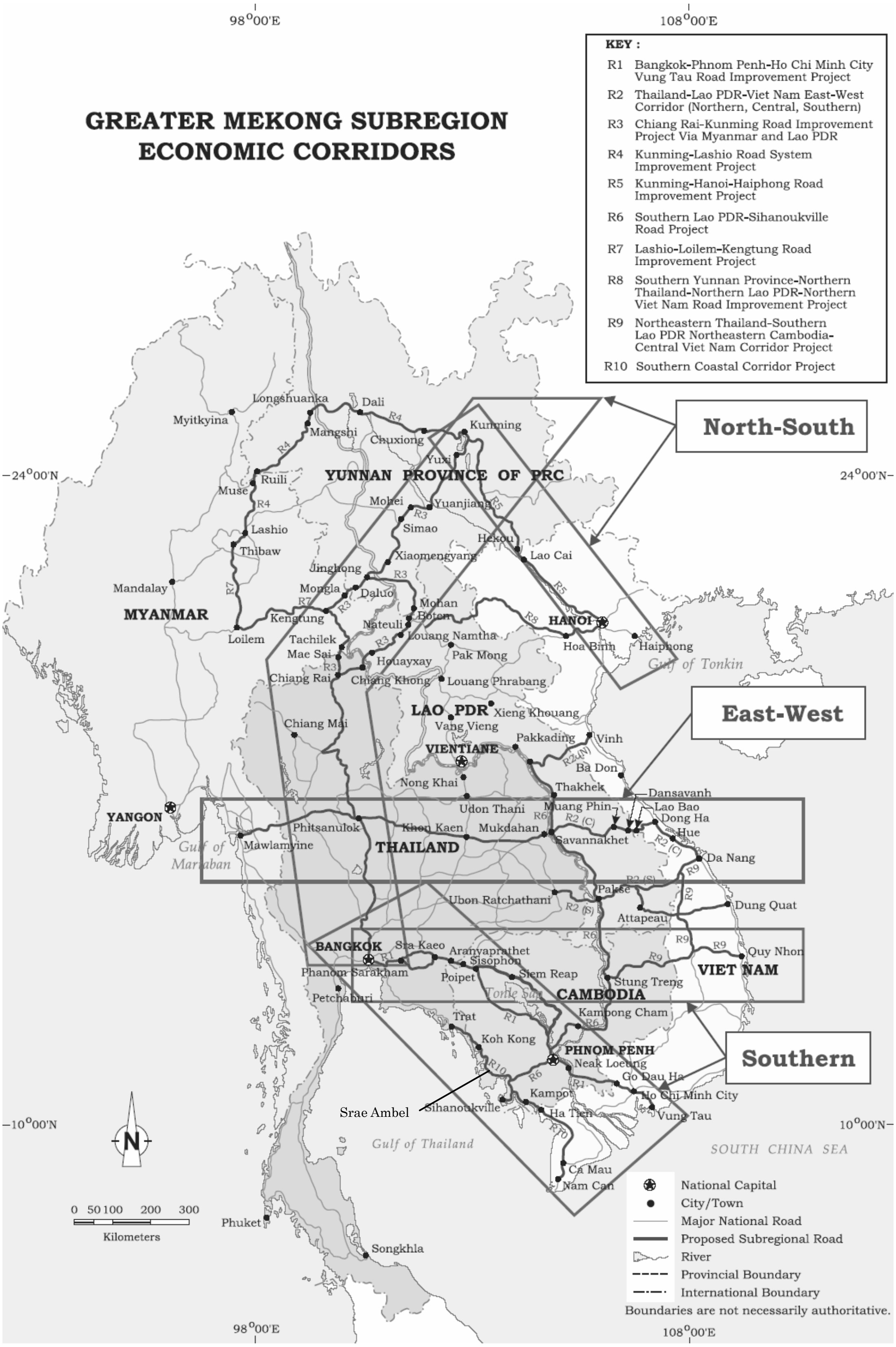
R1 is the Central Subcorridor of the Southern Economic Corridor (SEC). R2 is part of the East-West Economic Corridor (EWEC). R3 and R5 are parts of the North-South Economic Corridor (NSEC). The purpose of the projects is to construct and improve road infrastructure only. Nevertheless, the economic effects of the cross-border road infrastructure turned out to be larger based on the concept of the economic corridors and CBTA.

4.2 Three Economic Corridors

The concept of economic corridors was introduced at the Seventh Ministerial Meeting in 1998 at the time when its project implementation had been stagnated by the Asian currency Crisis. It was born to serve as a primer mover to conquer the difficulties after the crisis.

The basic idea of the economic corridors is to vivify economic activities along the

Figure 3: Three Economic Corridors in the Greater Mekong Subregion.



Source: ADB(2002).

transport corridor through the CBTI. Concrete examples, include: the establishments of industrial estates on the border area; the construction of telecommunication and electricity transmission cables; and, natural gas pipelines and tourism activities along the corridors.

The three economic corridors, composed of the EWEC, the NSEC and the SEC (Figure 3), were formally launched during the eighth Ministerial Meeting in 2000.

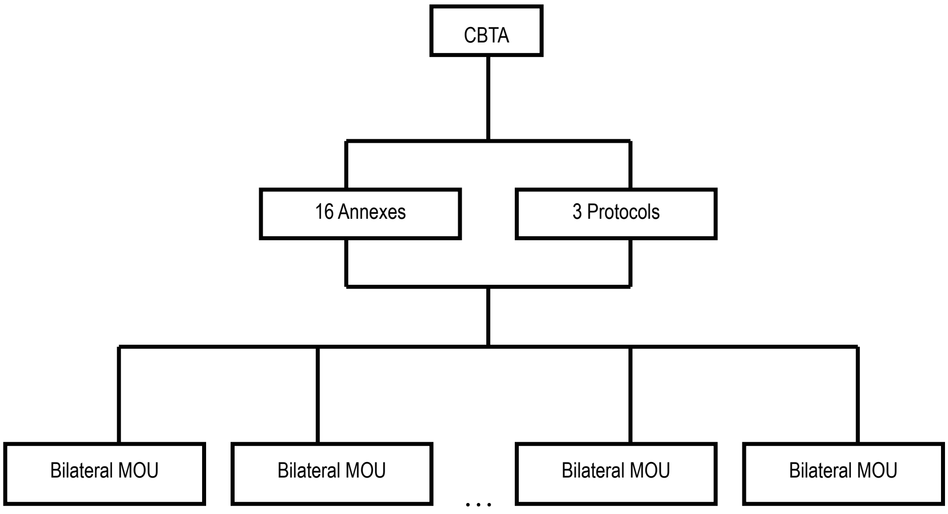
4.3 Cross-Border Transport Agreement

As the program entered into the second stage, some Member Countries emphasized the need for soft infrastructure or the removal of the nonphysical barriers that hindered free movements of commodities and people at the borders. Thus, this was considered at the second meeting of subregional transportation forum (STF) in 1995 and resulted in an agreement to conduct studies to realize such needs.

The studies examined the problems that prevent the free movement of commodities and people in the region and the existing international conventions on the cross-border movement of commodities and people. These studies were the basis of the STF in drawing the basic framework of the CBTA, that was explained at the seminars of the Member Countries. Consequently, Thailand, Laos and Vietnam signed the CBTA in 1999. Afterwards, Cambodia signed in 2001, China in 2002, and Myanmar in 2003 through the negotiation and amendment of some articles. Thus, by 2003, all the six Member Countries had already signed the CBTA.

Details of the CBTA, as provided in its 16 annexes and three protocols, were agreed by the Member Countries in March 20, 2007. Bilateral memorandums of understanding (MOU), in line with the CBTA (its annexes and protocols), for the

Figure 4: Stratum Structure of CBTA.



Source: Author in accordance with ADB (2002).

following borders were agreed upon (Figure 4).

1) Lao Bao, Vietnam and Danh Savanh, Laos on the EWEC
2) Savannakhet, Laos and Mukdahan, Thailand on the EWEC
3) Aranyaprathet, Thailand and Poipet, Cambodia on the SEC
4) Bavet, Cambodia and Mocbai, Vietnam on the SEC

As a matter of fact, beautiful pictures were drawn in the article of MOU, but they are far from the realities. Nevertheless, as a trial to realize the CBTA, the "single stop" inspection had already been undertaken at the borders of Lao Bao, Vietnam and Danh Savanh, Laos. The process of the single stop inspection involves the following phases:

Phase 1. Customs of exporting countries and importing countries are integrated to importing countries. This phase has been started already.

Phase 2. Documents for the customs clearance of the two countries are integrated.

Phase 3. Processes for quarantine of the two countries are integrated with the importing countries.

Phase 4. Processes for migration of the two countries are integrated to importing countries.

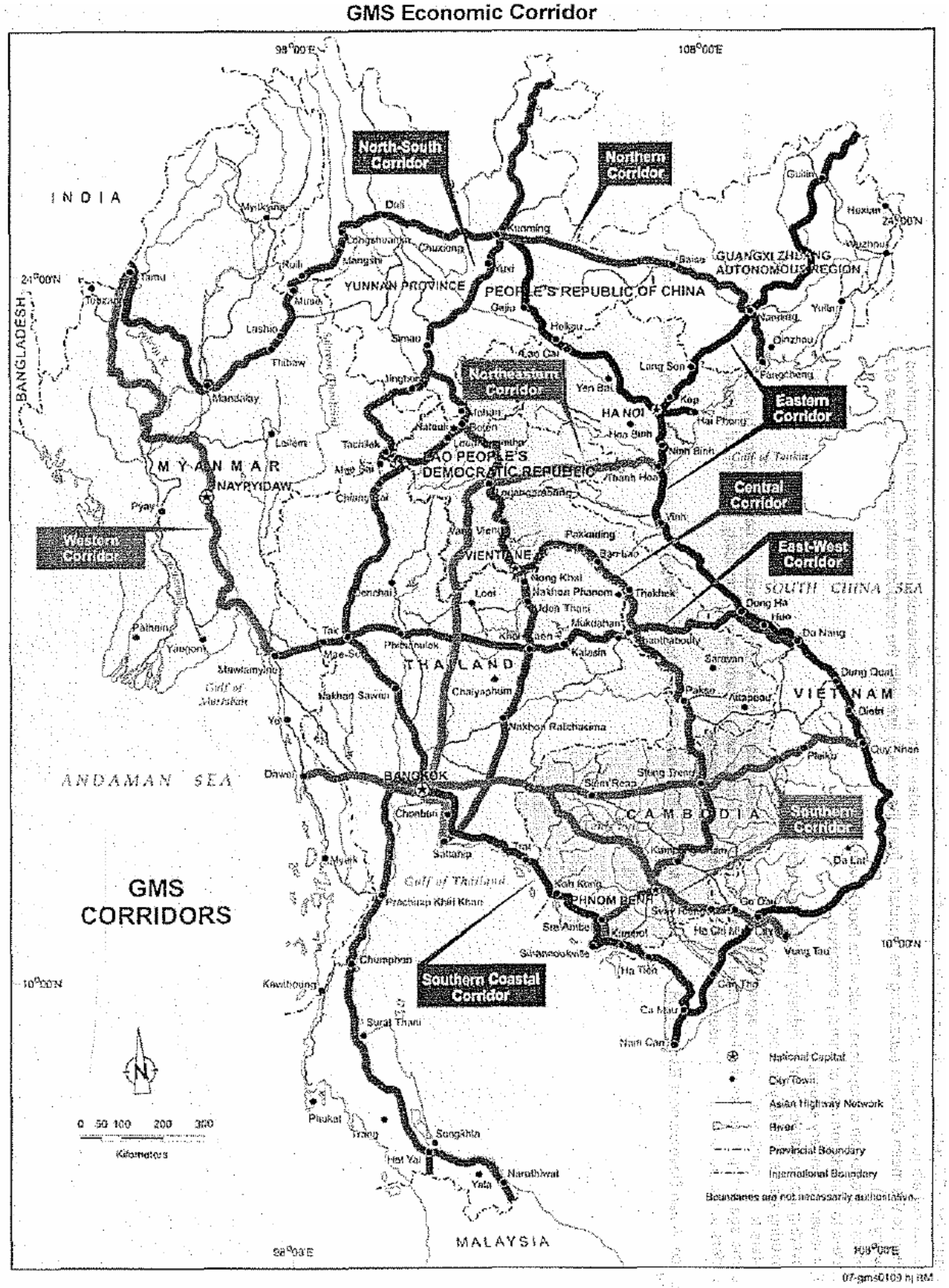
Furthermore, CBTA is explained to shorten the loading and unloading process through the release of Truck passport, that is the country's permit for a vehicle to pass from one country to another. A good example is the case wherein trucks can cross the borders between Thailand and Laos, and between Laos and Vietnam; but, trucks of Thailand and Vietnam cannot cross from each other's boarders.

4.4 New Economic corridors

The 14th Ministerial Conference of GMS-ECP held in Manila on June 19-21, 2007, endorsed the Mid-Term Review of its 10-Year Strategic Framework (2002 – 2012). A draft for discussion, entitled *Mid-Term Review of the Greater Mekong Subregion Strategic Framework 2002 – 2012*, was published on ADB website. Based on the map of GMS economic corridor, new economic corridors were added, and some parts of North-South Economic Corridor were changed (Figure 5):

The Eastern Economic Corridor (EEC) is based on National Road No. 1 (NR 1) of Vietnam (between Camau and Dongdang); NR 322 or Expressway No. 075 (between Youyiguan and Guilin passing through Nanning of Guangxi Zhuang Autonomous Region); and, Changsha of Hunan Province (through an extension of the road). The Western Economic Corridor (WEC) is part of the Route No. 1 of Asian Highway and it

Figure 5: New Economic Corridors in the Greater Mekong Subregion.



Source: ADB (2007b).

Remarks

Eastern Economic Corridor : – Guilin – Nanning – Hanoi – Danang – Ho Chi Minh – Camau
Western Economic Corridor: Tam – Naypydaw – Mawlamyaine
Northern Economic Corridor: Fangcheng – Nanning – Kunming – Mandalay – Tamu
Northeastern Economic Corridor: Bangkok – Lom Sak – Luang Phrabang – Thanh Hoa
North-South Economic Corridor: – Kunming – Tak – Bangkok – Narathiwat –
Central Economic Corridor: Boten – Muang Xai – Luang Phrabang – Vientiane – Pakse – Stung Treng – Phnompenh – Sihanouk Ville
Other Economic Corridors: Sattahip – Chonburi – Bangkok – Dawei
: Bangkok – Nakhon Ratchasima – Khon Kaen – Vientiane

connects Mawlamyaine and Tam (through the new capital of Naypydaw) and Imphal of Northern Part of India (extension road). The Northern Economic Corridor (NEC) connects Guangxi Zhuang Autonomous Region, Yunnan Province, Myanmar, Fangcheng (the port city), and Imphal (located on the extension of Tam). This economic corridor plans to connect China and India by road. The Northeastern Economic Corridor (NEEC) passes in relatively underdeveloped areas. Both peripheries of the North-South Economic Corridor have changed; the north edge is Shuifemg (border of Yunnan Province and Sichuan Province); and, Chongqing is located on its extension roads. The Southern edge is extended from Bangkok to Narathiwat, while Kuala Lumpur and Singapore is located on its respective extension roads. As a result, the routes were changed and the junction of the EWEC was transferred from Phitsanulok to Tak on NR 1 of Thailand. The Central Economic Corridor basically connects Laos and Cambodia from Boten, the Lao border with China up to the port of Sihanouk Ville.

With regards to the other economic corridors: the route between Sattahip and Dawei connects the Eastern Seaboard Area (the most industrialized area in the region) to the one route passing through the deepest port of Andaman Sea. In this way, the commodities produced in the Eastern Seaboard Area can be exported to India, the Middle East, and Europe without passing the Malacca strait. This corridor also gives Myanmar a short-cut route to the Pacific Ocean. The other route between Bangkok and Vientiane is the same with that of the NR 2 of Thailand.

5. THE IMPACTS OF ECONOMIC CORRIDORS AND FAVORABLE PROJECTS

5.1 After the Completion of the Second Mekong International Bridges

EWEC has been opened since the completion of the Second Mekong International Bridge between Savannakhet, Laos and Mukdahan, Thailand. However, some parts of the road between Thailand and Myanmar have not been paved and still operate on single lane. The NSEC is expected to be opened by the completion of another Mekong international bridge between Chiang Khong and Huay Xai in 2011. The Central Subcorridor of the SEC is also expected to be opened with the completion of Mekong River bridge of Neak Loeang in Cambodia.

The completion of the Second Mekong International Bridge is surely an epoch-making event in the development of the East-West Economic Corridor. However, the business community paid more attention to the Bangkok-Hanoi Road than the EWEC (Ishida, 2007a). Part of the EWEC, which also includes some parts of Laos, will be utilized for the movement of commodities between Bangkok and Hanoi. The government of Laos expressed worries on this situation, referring to a possibility that the Lao part of the EWEC is only being utilized for transit trucks between Bangkok and Hanoi. In the same manner, its government worries that the Cambodian part of the Central Subcorridor of the SEC will only be utilized for transit of trucks between

Bangkok and Ho Chi Minh City.

As a matter of fact, the completion of the abovementioned bridges of Mekong River will likely to increase transportation among the mega-cities like Bangkok, Ho Chi Minh and Hanoi. Such increases could cause further agglomeration of people and industries and expands the gap between major cities and rural communities along the economic corridors. In order to narrow the gap between rural communities and mega-cities along the corridors, the Member Countries should consider some favorable ideas/projects. As mentioned in the preinvestment survey, EWEC was designed to utilize the geographical features for its effective utilization; border areas, junctions and ports as gateways (ADB, 2001).

5.2 Special Economic Zones at Border Areas

In the GMS-ECP, the development of border areas has been the focus of intervention. These areas had been treated not only as peripheries, but also as the battle fields where opposing military forces faced each other prior the 1992 GMS-ECP inauguration. It is because border areas have several and unique advantages. For example, in a project at the border between a higher income country and a lower income country, the former can utilize labor forces of the latter at lower wages (compared to what they used to pay). Another example is about the resource endowments between a country with better economic infrastructures and that with poorer infrastructures. People from the latter can have access to supply of energy, telecommunication lines, water, and ports. Accordingly, dynamism can be born out of differences in factors and resource endowments between the two countries at border areas (Kudo, 2007).

Table 1 shows that special economic zones have been planned and some of them

Table 1: Realized and Planned Special Economic Zones.

Borders		Provinces	Values in Border Provinces as of 2003					
			Populations (1,000 persons)		Densities (Persons/Km^2)		GPP/cap. ($US)	
Bavet–Mocbai	CV	Svay Rieng-Tay Ninh	551.0	1,017.1	185.8	252.4		366.1
Koh Kong–Trat	CT		182.0	225.0	16.3	79.8		1,542.2
Poipet-Aranya Prathet	CT	Banteay Mean Chey-Sa Kaeo	748.0	541.4	75.3	75.3		920.5
Denh Savanh– Lao Bao	LV	Savannakhet–Quang Tri	833.9	608.5	38.3	128.2	300.9	234.0
Savannakhet-Mukdahan	LT		833.9	339.1	38.3	78.1	300.9	600.6
Thanaleng - Nong Kai	LT	Vientiane-Nong Khai	650.6	913.3	166.0	124.6	1,005.0	576.5
Huai Xai - Chiang Khong	LT	Bokeo-Chiang Rai	141.0	1,214.9	22.8	104.0	231.1	743.7
Myawaddy - Mae Sot	MT	Karen–Tak	1,607.0	498.7	52.9	30.4	309.3	1,010.8
Tachilek - Mae Sai	MT	Shan-Chiang Rai	5,142.0	1,214.9	33.0	104.0	448.3	743.7

Remarks: Data for the GPP per capita are very rough estimates. These were obtained using the following processes:

1) The GPP per capita in Vietnam was obtained by multiplying monthly per capita income (based on 2003-2004 household survey), with the population of provinces, by 12 months.
2) The GPP per capita in Laos was is a deflated value of 2005. It was obtained by dividing the GDP per capita ratio of 2005 by that of 2003 (based on ADB's *Key Indicators)*.
3) The GRP per capita in Myanmar is based on inflated monthly household expenditure values from a 2001 survey. It was calculated by multiplying the GDP per capita ratio of 2003 by that of 2001 (based on ADB's *Key Indicators)*. Annual expenditure per capita is obtained by dividing the annual expenditure per household by the value of the averaged household size and multiplying its quotient by 12 months.

Sources: Distances:

- Vietnam: Giao Thong Duong Bo Viet Nam, *Tap Ban Do, Thong Duong Bo Viet Nam*.
- Laos: measure through an automobile odometer when I traversed the route in August 31, 2006.
- Thailand: measured from the *Road Map of Thailand 2005-2006,* compact disk (CD), think net.
- Myanmar: measured with a ruler from the *Global Travel Map, Myanmar*, Asia Books. Area, Population and Income.
- Vietnam: General Statistics Office (2004) *Statistical Yearbook 2003*. General Statistics Office (2006); *Results of the Survey on Households Living Standards,* a paper presented in a workshop in Hanoi, January, 2006.
- Laos: collected from the Provincial Office of Laos.
- Thailand: National Statistical Office (Various Years) *Statistical Yearbook Thailand*.
- Myanmar: Central Statistical Organization (2002) *Statistical Yearbook 2002*. Exchange Rates
- Countries except Myanmar: IMF (Various Years) *International Financial Statistics*.
- Myanmar: the average value of daily exchange rates of the Foreign Exchange Certificate (FEC) Exchange Center in 2001 (based on the Tokyo Mitsubishi Bank).

had already been operating. In the Lao and Thai borders of Thanaleng – Nong Khai, a lot of manufacturing factories have already been operating along the road between the center of Vientiane city and Mekong Friendship Bridge even if it was not a GMS Planned Special Economic Zone. Similarly, an industrial estate had been developed at Bavet in Cambodia by the Manhattan Development, Ltd. with three foreign companies operating. In Lao Bao, Vietnam, a special economic zone had been built, also. Several manufacturing companies had been operating and many imported goods are being sold at duty free shops at the border area. In Mae Sot, Thailand, a lot of Thai companies produce garments by employing workers of Myanmar at cheaper wages.

On the other hand, enclosed lands had been prepared and designated for the special economic zones at Poipet and Koh Kong, but as of 2007, no company has built any factory in the area. In Savannakhet, a special economic zone had been planned with an investor intending to build an industrial estate at Savan district near the Second Mekong International Bridge. To this date, the whole land has not been bought from its inhabitants. As for the borders of Huai Xai – Chiang Khong and Tachilek – Mae Sai, the province of Chiang Rai is considered as a gateway for Laos and Myanmar while Chiang Saen Port of Mekong River plays a strategic gateway for Yunnan Province of China. A special economic zone has been planned in the area, but no investor has emerged so far.

Examining the provincial values of population, population density and gross provincial product (GPP) of border provinces in Table 1 revealed that provinces who have operational special border economic zones have relatively higher population densities (e.g., Bavet, Lao Bao and Thanaleng), while those some of having not been realized are caused by other reasons. An exception is the case in Mae Sot, where garment factories hire legal and illegal migrant workers from Myanmar causing the increase in its population at the border area. It is also important to consider that provincial data do not always reflect the actual situation at the border, particularly, in big provinces (by area) like Shan and Karen in Myanmar.

As far as seeing the data of population density, the possibility of Savannakhet as a location of an industrial estate can be doubted. Although it is the second largest province in Laos, but the population density is smaller and its population are scattered. As a matter of fact, most of investors planned to invest in plantation and agricultural sectors, while the number of approved investors dramatically increased in 2006 before the completion of Second Mekong International Bridge (Keola, 2007). The population of Koh Kong is also relatively small and it is in the similar situation. As a matter of fact, Khon Kaen Sugar Industry Public Company, Ltd. (Thai company) which has been the share holder of Savannakhet Sugar Corp. and Koh Kong Plantation Co., Ltd., has been granted concessions of 10,000 and 20,000 ha, respectively in Savannakhet and Koh Kong (*The Nation*, August 17, 2007).

Locating industrial estates at border areas with relatively smaller population is not appropriate as far as a large scale of labor migration does not occur; it cannot make use of abundant labor force with cheaper wages. Instead, such areas should make use of other factor endowments with comparative advantages like abundant land and natural resources. Needles to say, however, developing such border areas should be socially and environmentally sustainable.

5.3 Making Use of Junctions

The preinvestment survey for the EWEC in 2001 enumerates Phitsanulok, Khon Kaen and Dong Ha as intersection or junctions of the NSEC, the National Road No.2 (NR 2) of Thailand and the NR 1 of Vietnam, respectively. Specifically in Phitsanulok, commodities produced at cities or villages along the EWEC can be transported to cities and villages along the NSEC like Chiang Mai, Kunming, and Bangkok; the same happens with commodities from the NSEC to the EWEC. Similarly, at Khon Kaen, the NR 2 of Thailand can transport goods to Vientiane, Nakhon Ratchasima and Bangkok; and at Dong Ha, NR 1 of Vietnam can transport goods to Hanoi and Ho Chi Minh Cities.

In addition to the abovementioned junctions, Seno district in Savannakhet, where the EWEC crosses with NR 13 of Laos, is a very important junction. Savannakhet is a special economic zone and Seno was either mentioned alone or with Savan. NR 13 is the most important passage in Laos, that connects major cities like Luang Phrabang, Vientiane, Savannakhet and Pakse. In fact, Japan Logistic System Corp established a joint venture with Logitem Laos GLKP Co., Ltd.. It started operating an interland container depot (ICT) at Seno district on October 1, 2007. The joint venture transfers freights between Bangkok and Hanoi. This reiterates that Seno is not only an important junction in NR 13, it also serves as transfer point for freights between Bangkok and Hanoi. Thus, Savannakhet remains a strategically important location even if it may not be an appropriate location for industrial estate. Similarly, developing ICT has been planned at Khon Kaen and Phitsanulok. (Tsuneishi, 2007, p.21). Based on the map of new economic corridors (Figure 5), Table 2 enumerates all other junctions.

5.4 Major Cities and Ports as Potential Markets

Table 2 enumerates the major cities and ports, which are important and export potential markets. For CLMV countries, there are many other major markets in Thailand and

Table 2: Junctions of Economic Corridors, Major Cities and, Ports along them.

Junctions	Country	Corridors and Major Cities and Ports		Corridors and Major Cities and Ports	
Tak	Thailand	EWEC	Danang, Khon Kaen, Maulamyaine	NSEC	Bangkok, Kunming
Phitsanulok	Thailand	EWEC		NSEC	
Khon Kaen	Thailand	EWEC		NR 2	Bangkok, Vientiane
Savannakhet	Laos	EWEC		CEC	Vientiane, Phnom Penh, Sihanouk Ville
Dong Ha	Vietnam	EWEC		EEC	Hanoi, Danang, Ho Chi Minh
Luang Phrabang	Laos	NEEC	Bangkok, Hanoi	CEC	Kunming, Vientiane, Phnom Penh
Stung Treng	Cambodia	SEC	Siem Reap, Quy Nhon	CEC	
Sre Ambel	Cambodia	SEC	Eastern Sea Board Area	CEC	Phnom Penh, Vientiane

Source: Prepared by the author based on Figure 5.

China. Provinces near major cities can also serve as potential markets, as in the case of Ayutthaya and Rayong Provinces in Bangkok. Because of the many factories established in these areas, income level was found to be relatively higher. And, Member Countries of the CLMV has many important major cities such as Phnom Penh, Vientiane, Yangon, Mandalay, Hanoi and Ho Chi Minh. Connecting these major cities by roads is very strategic in marketing the goods they produced (Table 3).

Along with economic growth is the risk of traffic jams. Major national roads most likely converge in major cities like Bangkok, Hanoi, Ho Chi Minh and Phnom Penh. Thus, outer ring roads are needed to connect major national roads while avoiding possible traffic jams.

Ports are the gateways for export markets. The same is true with bringing the goods produced in CLMV countries to the overseas market. In the Mekong Region,

Table 3: Population and Economic Indicators of Major Cities in GMS Area in 2003.

		Area (1,000 Km^2)	Population (1,000 Persons)	Density (Persons/Km^2)	GPP/Cap. (US$)	GPP (million US$)
Phnom Phen	Cambodia	267.0	1,283.0	4,805.2		
Kampong Cham	Cambodia	9,799.0	1,805.0	184.2		
Vientiane	Laos	3,920.0	650.6	166.0	824.4	536.3
Yangon	Myanmar	10,166.9	6,188.0	608.6	208.8	1,292.2
Mandalay	Myanmar	37,008.1	7,407.0	200.1	183.6	1,359.7
Ho Chi Minh	Vietnam	2,095.2	5,554.8	2,651.2	894.5	4,968.8
Ha Noi	Vietnam	921.0	3,007.0	3,264.9	619.6	1,863.2
Danang	Vietnam	1,255.5	747.1	595.1	514.7	384.5
Bangkok	Thailand	1,565.2	5,844.6	3,734.1	7,215.8	42,173.4
Chiang Mai	Thailand	20,107.1	1,603.2	79.7	1,356.5	2,174.7
Nakhon Ratchasima	Thailand	20,494.0	2,591.1	126.4	1,028.2	2,664.0
Khon Kaen	Thailand	10,886.0	1,770.6	162.6	1,143.4	2,024.4
Ayutthaya	Thailand	5,890.1	751.3	127.5	3,403.1	2,556.6
Rayong	Thailand	3,552.0	556.7	156.7	13,726.8	7,642.2
Kunming	China	21,582.0	5,008.0	232.0	1,963.8	9,834.6
Nanning	China	-	6,416.7	-	946.2	6,071.4

Sources and Remarks: Same in Table 1.

Laem Chabang Port and Khlong Toey Port play the most important role in export marketing. Export goods produced in Laos are usually transported through these sea ports. Likewise, Cambodia, Myanmar, Southern Vietnam and Northern Vietnam uses the Sihanouk Ville, Yangon, Saigon and Haiphong ports as feeder ports to Hong Kong or Singapore, respectively (Table 4).

For the cities and villages in the EWEC, the Danang and Maulamyine ports are designed as the gateways to the Pacific and Indian Oceans, respectively. Danang port (Tiensa), specifically, was expected to be one of the deepest ports in Vietnam. However, the quantity of container cargos is less than those in Saigon and Haiphong. The latter

Table 4: Major Sea Ports in the Mekong Region

Port	Country	Location	Depth (m)	Container Throughput (TEU/Year)
Sihanouk Ville	Cambodia	Sea	8.3	231 (2006)
Phnom Penh	Cambodia	River	5	-
Yangon	Myanmar	River	9	129 (1999)
Thilawa	Myanmar	River	10	-
Maulamyaine	Myanmar	Sea	-	-
Dawei	Myanmar	Sea	12	-
Khlong Toey	Thailand	River	8	-
Laem Chabang	Thailand	Sea	14	4,642 (2006-07)
Map Ta Phut	Thailand	Sea	10	-
Saigon	Vietnam	River	10	1,200 (2005)
Thi Vai & Cai Mep	Vietnam	River	15	-
Qui Nhon	Vietnam	Sea	-	-
Danang	Vietnam	Sea	12	34 (2005)
Hai Phong	Vietnam	River	8	400 (2005)
Cailan	Vietnam	Sea	12	-

Sources: Ishida (2007b), *Port Autonome de Sihanoukville*, web sites of Institution for Transport Policy Studies and *News Net Asia* on December 4, 2007.

rivers ports, however, are relatively shallow. The smaller quantity of cargo reflects the level of industrialization in Danang City. If the port city is less industrialized, the quantity of cargos becomes smaller; thus, lesser ships dock in the port. Furthermore, lesser ship implies that the location is not attractive for an export-oriented investment. The development of industries and transport infrastructures mutually need each other. The port of Maulamyine was expected to reduce the transport time, by passing through the Malay Peninsula and the Malacca Strait, to exports goods from Thailand to Europe and the Middle East. However, it has not been developed because the area is shallow and still needs to be dredged. Dawei is another potential deep sea port. Thus, a road connecting Bangkok and Dawei has been planned as a new economic corridor.

As for the other sea ports, Thilawa, Chi Vai and Cai Mep, and Cailan port will also be developed to serve as the substitutive sea ports of Yangon, Saigon and Hai Phong, respectively. The Map Ta Phut Port is being used primarily as an industrial port in a chemical industrial complex. Lastly, Qui Nhon Port is expected to serve the border areas of North Sub-Corridor of the SEC.

6. CONCLUDING REMARK

The GMS-ECP has been focused in the development of transport infrastructure. By all means, spreading and expanding transport infrastructure network is effective for the remote villages to sell their goods to major markets in the region as well as overseas. Needless to say, however, to be able to increase the function of transportation network, efforts to reduce cross-border barriers such as CBTA, the use of junctions, and ports for exports, are needed. In addition, it is also necessary to recognize the marketing demands and needs of remote areas.

More than giving opportunities for remote areas to sell their goods, it is also strategic to develop border areas as special economic regions. At the borders between relatively developed countries, like Thailand and underdeveloped countries, the differences of factors and resource endowments can create dynamism for the advantage of both.

Finally, the GMS-ECP can be considered as the most effective development scheme in the region among the other economic cooperation schemes that had been implemented (i.e., AIA and ACMECS). Future development in the region will be implemented along the railway of the economic cooperation program. As learned from the case of Danang Port, however, developing of infrastructure alone does not bear fruits but its relation to the overall welfare of every Member Country. Furthermore, the greater roles played by the public sector in the GMS-ECP is significant in operationalization of the objectives of GMS-ECP. In the future, however, an industrial development driven by private sectors maybe explored.

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Chapter 5

INVESTMENT CLIMATES IN CLMV: THEIR GLOBAL POSITIONS

Souknilanh Keola

ABSTRACT

This report attempted to identify investment climates in Cambodia, Lao PDR, Myanmar, and Vietnam (CLMV). First, it re-arranged investment climates into (1) macroeconomic factors, (2) infrastructures, (3) supply and demand factors, and (4) policy factors. Then, it made an attempt to evaluate CLMV's positions for each factors by making a comparison across as many countries as possible based on statistics and indices made available by international institutions, national statistical authorities etc. A set of possible policy implications have also been provided as possible ways to improve investment climates in CLMV.

1. DEFINITION

Before making any attempt to examine the investment climates in CLMV, it is first necessary to provide a common definition of investment climate that will be used in this report. Until now, many academic and nonacademic papers have provided a variety of definitions.

David et all (2003) defined investment climate as the institutional, policy, and regulatory environment in which firms operate. The World Bank's *World Development Report 2005* titled "A Better Investment Climate for Everyone" broadened the definition to "The investment climate reflects the many location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs, and expand." Phillips (2006) divided investment climates into governance and infrastructure components while stating that healthy investment climate includes economic and political stability, rule of law, adequate infrastructure, tax and regulations conducive to doing business, labor policies, and access to finance. Recently, Ho (2006) described investment climate constrains to be primarily policies or resources.

It is obvious that government policies and infrastructures are very important factors determining investment climates based on these definitions. However, few of them put emphasis, at least explicitly, on supply/demand factors such as population sizes and other resources in the places of investment. Population is very important for investment activities in two ways. They can be inputs to production or labor, and can serve as consumers of the final products. This is termed the "home market effect" and is regarded as one of most important determinants of agglomeration forces in spatial economics.

Putting more emphasis on supply and demand factors, this report re-categorizes investment climates into (1) macroeconomic factors, (2) infrastructures, (3) supply and demand factors, and (4) policy factors. It is easy to see that these different factors are all interconnected, and can be substituted. As a result, it is natural to assume that the same level of investment climates can be achieved by different sets and/or levels of each factor of investment climates.

Several indicators will be selected and presented to examine the investment climates in CLMV. Comparison will be made across as many countries or regions as possible.

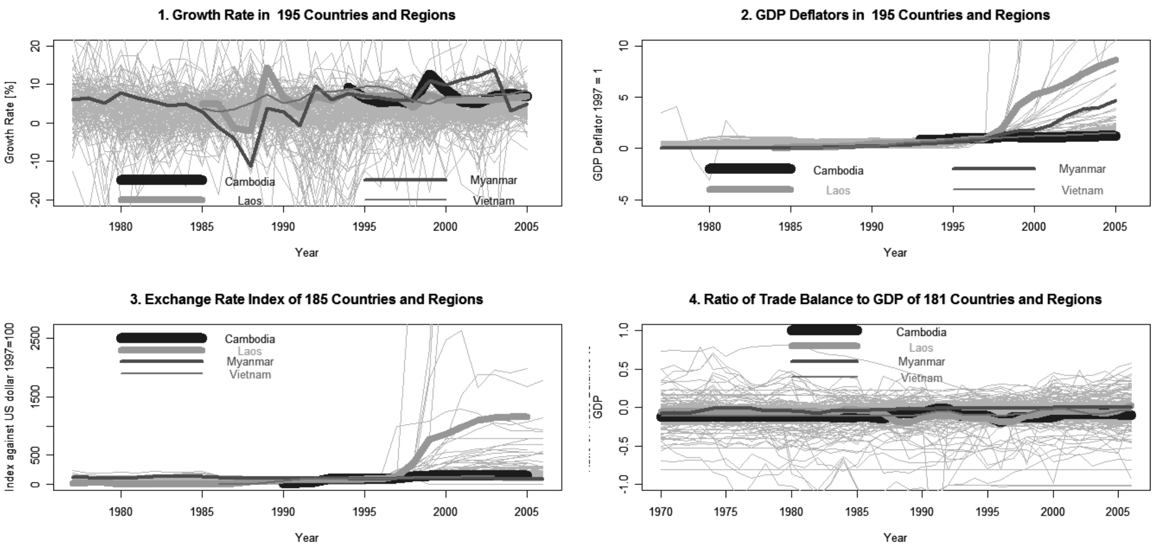
2. MACRO ECONOMIC FACTORS

While macroeconomic factors can be strongly influenced by policies, they are not included as policy factors due to their market-oriented nature. As indicators of macroeconomic factors, the following have been selected: (1) economic growth rate, (2) GDP deflator, (3) foreign exchange rate, and (4) ratio of trade balance to GDP.

Growth rate was selected because, in general, a place that grows faster may be considered more attractive as an investment destination due to the higher possibility of more gain. Figure 1.1 depicts the growth rates of 195 countries and regions from 1977 to 2005. In this period, majority of economies in the world managed to grow in the range of -10 percent to 10 percent annually. For CLMV, Myanmar was the only country with data on growth rate available throughout the period. Laos and Vietnam did not have data until their adoption of policies for transition to market economy in the mid-1980s. Figures for Cambodia were not available before 1994, or one year after the civil war in the country was finally ended by active involvement of the United Nations.

Cambodia had been growing steadily since 1994, with a two-digit growth rate in 1999. Laos adopted a policy to transform the economy from a centrally planned to a market-oriented economy, but only achieved significant growth when it began accepting foreign direct investment at the end of 1988. Myanmar achieved relatively high growth from the late 1970s to the mid-1980s, but then experienced a negative growth toward the end of the 1980s. The economy began to grow again from the mid-1990s with a quite steep fluctuation from time to time. Vietnam can be considered the country with the most steadied growth, but with its huge domestic market, the prospect may be even brighter. Vietnam is actually beginning to compete with some of its former ASEAN members that have not done well economically since the latter half of the 1990s. However, putting their individual progress aside, CLMV as a whole have done quite well in terms of economic growth since the 1990s by staying on a top level globally, in terms of growth rates.

Figure 1: Macroeconomic Factors



Source: Drawn by author based on Common Database, United Nations.

GDP deflators and exchange rates against the US dollar were chosen as indicators of stability of national currencies in both domestic and foreign markets. Figure 1.2 and 1.3 depicts GDP deflators and exchange rates of 195 and 186 countries and regions around the world, respectively. Most countries and regions around the world are more or less stable in terms of prices during 1977 to 2005 when compared to growth rates. Except for a few countries, GDP deflators are slightly more than zero. Cambodia and Vietnam managed to follow this trend of the majority, while Laos and Myanmar did not. Laos was the most unstable among CLMV after 1997 and toward the beginning of 2000s. GDP deflator, a proxy of consumer price index, inflated to almost 10 times in Laos after the Asian financial crisis that broke out in late 1996. Myanmar experienced inflation fivefold and a demonetization of its currency in a few occasions.

In terms of the value against the US dollar of the national currencies of 185 countries and regions in the world during 1977 to 2005, a sharp depreciation can be observed after the Asian financial crisis. Even among former members of ASEAN, a depreciation from 100 to several thousand percent had been observed. However, among CLMV, the depreciation of the LAK (Lao Kip), Laos' national currency, was by far the largest. Myanmar had been stable according to statistics, although there is a need to take into account the fact that Myanmar is the only country that still maintains several exchange rate systems among CLMV.

Figure 1.4 depicts trade balances as percentage to GDP of 181 countries or regions. It shows that the percentage to GDP of trade balance of most countries and regions are in the range of -5 percent to slightly above 2 percent. CLMV lie in the range between -1 percent to about 0 percent of GDP, and are therefore doing "not so bad and not so good" in terms of trade balance among countries or regions in the world.

Therefore, besides the instability of the LAK during 1997 to early 2000s and the not-so-stable financial condition in Myanmar, all of CLMV's macroeconomic factors have been relatively well since the 1990s by world's average standard.

3. INFRASTRUCTURES

Infrastructures are important to economic activities including investment. Table 1 shows the indices of general infrastructures such as road, railway, water, electricity, and telecommunication. Those for Malaysia, Singapore, and Thailand have also been added as the benchmarks that CLMV may aim for.

Among CLMV, road density (total road length divided by total land area) is lowest in Myanmar, higher in Cambodia and Laos, and highest in Vietnam. While one may safely say that more roads will need to be constructed in CLMV considering the very high road density in Singapore or Malaysia, the optimal levels can, however, vary. This is because differences in population densities and their distributions may also lead to different lengths and forms of road to be constructed.

Moreover, quality does matter more when it comes to using roads. While road density is not high in Thailand, its road network is by far better than those in CLMV, including Vietnam that has a higher road density according to statistics. In Thailand, most national roads are generally separated from the roads used daily by local people living along them, making it possible for cars and trucks to travel at a higher speed.

A total of about 650-km-long railway system exists in Cambodia. Though the construction of a 3-km-long railway from the First Friendship Mekong Bridge between Laos and Thailand has been in progress since mid-2007, Laos is still the only country in the ASEAN without a railway besides the city-state of Brunei. Longer railway networks, mainly connecting cities from north to south, exist in Myanmar and Vietnam, but improvement is likely necessary for them to be used as economic corridors.

Almost half of households in Cambodia and Laos still have no access to clean water. The situation is better in Myanmar and Vietnam, but still not good enough when compared to Malaysia, Singapore, and Thailand. Electricity is not only important for better livelihood; it is also indispensible for modern economic activities. With electrification rate lower than 20 percent, electricity is obviously lacking in Cambodia.

Though Laos produces electricity, most of it is exported to Thailand, and therefore has not yet been adequately utilized for domestic economic activities. While the electrification rate is nearly 80 percent in Vietnam, this is still below the ideal target of 100 percent.

Telephone density (lines per 100 inhabitants) is 1.27 in Laos, 0.93 in Mynamar, and only 0.23 in Cambodia. In Vietnam, it is 18.81, which is even higher than the figures for Malaysia and Thailand. However, the trend of shifting from fixed line (or none) to mobile phones is obvious in Cambodia, Laos, and Vietnam, with Myanmar as the only exception. The percentage of mobile cellular subscribers to fixed line subscribers is higher than 90 percent in both Cambodia and Laos. Having less than one mobile cellular phone for every 100 inhabitants as in the case of Myanmar is extremely low even in CLV's standard.

Table 1: Infrastructures

	Cambodia	Laos	Myanmar	Vietnam	Malaysia	Singapore	Thailand
Road density, (year)	217 (2004)	135 (2003)	43 (1999)	717 (2004)	300 (2004)	4627 (2004)	112 (2000)
Railway length, km, (year)	650 (2004)	0	4759 (2000)	2600 (2004)	1949 (2004)	127.9 (2004)	4044 (2002)
Water access rate, 2004	41	50	78	85	99	100	99
Proportion of house holds with electricity, 2000	16.6	38.2		77.8 (1999)	97.3	100	98.3
telephone lines per 100 inhabitants, 2006, (2001)	0.23 (0.25)	1.27 (0.98)	0.93 (0.58)	18.81 (3.82)	16.83 (19.71)	42.32 (47.14)	10.92 (9.75)
Mobile cellular subscribers per 100 inhabitants, 2006	7.94	10.77	0.42	18.17	75.45	109.34	63.02
Internet subscribers per 100 inhabitants, 2006	0.09	0.1	0.01	4.76	18.08	52.78	3.81
Internet users per 100 inhabitants, 2006	0.31	0.42	0.18	17.21	54.23	43.62	13.07
Broadband subscribers per 100 inhabitants, 2006	0.01	0	0	0.61	3.49	18.19	0.16

Source: (1) ASEAN Secretariat (www.aseansec.org/). (2) UNESCAP (www.unescap.org/).

CLMV still have a long way to go in making use of the internet. Less than one in 1000 inhabitants in Cambodia, Laos, and Myanmar use the internet. According to figures from the ASEAN Secretariat, more people access the internet in Vietnam than in Thailand. However, when it comes to access via broadband connection, CLMV together with Malaysia and Thailand still have a long way to go before they can catch up with Singapore.

As a landlocked country, Laos has no sea ports. Table 2 shows the main ports in CMV. Cambodia has one sea port and two ports along the Mekong River. Myanmar has several international ports along its coastal line. Vietnam has the biggest number of ports but none of them can rival the much densely used ports of Singapore or even Thailand. While ports are almost indispensible as infrastructures for trade and economic activities, having only them would not help much. For instance, while many ports in Vietnam are closer to many parts of Laos than the ports in Thailand, most exporters in

Table 2: Main Ports in CMV

Cambodia	Myanmar	Vietnam
Sihanoukville	Yangon	Northern
Sihanoukville port	Yangon port	Hai Phong port,
Phnom Penh	Rakhine	Cua Cam Hai Phong port,
Phnom Penh port *	Sittwe port, Kyaukphu port,	Nghe Tinh port, Guang Ninh port,
Koh Kong	Thandwe port	Thanh Hoa port,
Koh Kong port *	Ayeyarwady	Central
	Pathein port	Danang port, Haison port,
	Mon	Ky Ha port, Nha Trang port,
	Mawlamyine port	Nguyen Ban Troi port,
	Tanintharyi	Quy Nhon port,
	Dawei port, Myaeik port,	Song Han port
	Kawthoung port	Southern
		Ben Nghe port, Cat Lai port,
		Can Tho port, Dong Nai port,
		Dong Thap port, My Tho port,
		My Thoi port,
		Tan Cang Saigon port,
		Tan Thuan Dong port,
		Saigon port, Saigon Petro port,
		Xang Gau Nha Be port

Source: (1) ASEAN Port Association (http://www.aseanports.com). (2) Royal Government of Cambodia's Website (http://www.cambodia.gov.kh/).
Note: * is port on Mekong river.

Laos still prefer the Thai ports apparently due to their lower prices, safer handling, and predictable times.

Airports are important to economic activities including investment. Cambodia has only two international airports but more than 20 airlines, most of them flying internationally. Laos has three international airports but with only five airlines that fly to and from the biggest airport in the capital city. Myanmar has two international airports but with relatively fewer flights compared to Cambodia. Vietnam has two big international airports in the north and south, and one smaller international airport in the central part.

While it is obvious that infrastructure development is an urgent need in CLMV to attract more investment, it is not easy for economies like them with relatively limited financial resources to develop infrastructures at a steady rate. However, many Asian

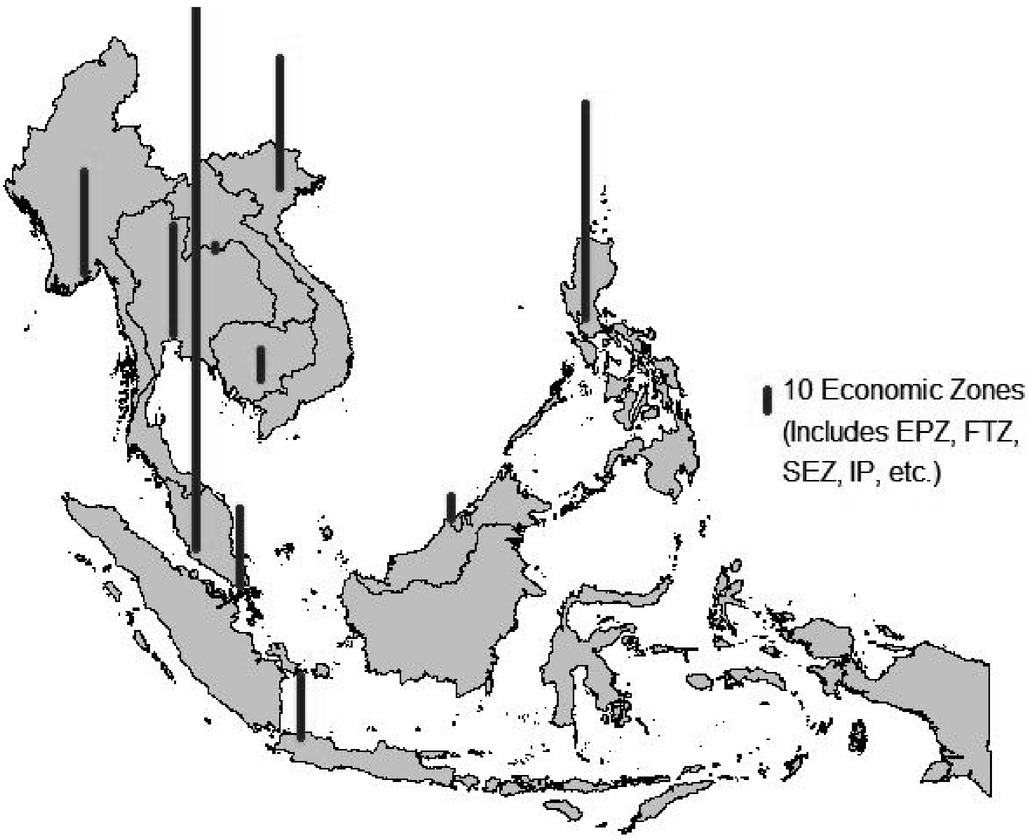
Table 3: International Airports and Operating Airlines

Cambodia	
Siem Riep International Airport	
	AirAsia,Thai AirAsia,Angkor Airlines,Asiana Airlines,Bangkok Airways, Cathay Pacific ,Dragonair, China Airlines,China Southern Airlines, EVA Air, Far Eastern Air Transport,Jetstar Asia Airways,Korean Air, Malaysia Airlines,President Airlines,PMTair,Royal Khmer Airlines, Royal Phnom Penh Airways, Shanghai Airlines, Siem Reap Airways, Singapore Airlines, SilkAir, Thai Airways International, Transmile Air Services, Vietnam Airlines
Phnom Penh International Airport	
	AirAsia, Air Macau, Angkor Airways, Asiana Airlines, Bangkok Airways, China Eastern Airlines, China Southern Airlines, Japan Airlines, Jetstar Asia Airways Kampuchea Airlines, Korean Air, Lao Airlines, Malaysia Airlines, PMTair, President Airlines, Royal Khmer Airlines, Royal Phnom Penh Airways, Siem Reap A Singapore Airlines, SilkAir, Vietnam Airlines
Laos	
Wattay International Airport	
	AirAsia, Cl China Southern Airlines, Lao Airlines, Thai Airways International, Vietnam Airlines
Luangphabang International Airport	
	Bangkok Airways, Lao Airlines, Siem Reap Airways, Vietnam Airlines
Pakxe International Airport	
	Bangkok Airways, Lao Airlines
Myanmar	
Yangon International Airport	
	Air Bagan, Air India IC, AirAsia, Thai AirAsia, Air Bagan, Air China, Air Mandalay, ATRAN Cargo Airlines, Bangkok Airways, China Airlines, Mandarin Airlines, China Southern Airlines, Hong Kong Express Airways, Jetstar Asia, Malaysia Airlines, Myanma Airways, Myanmar Airways International, Qatar Airways, Singapore Airlines, Silk Air, Thai Airways International, Vietnam Airlines, Yangon Airways
Mandalay International Airport	
	Air Bagan, Air Mandalay, China Eastern Airlines, Myanma Airways, Yangon Airways
Vietnam	
Noi Bai International Airport	
	Aeroflot, AirAsia, Thai AirAsia, Air Dream, Air France, Asiana Airlines, Cathay Pacific, China Airlines, China Southern Airlines, EVA Air, Uni Air, Hong Kong Japan Airlines, Korean Air, Lao Airlines, Malaysia Airlines, Pacific Airlines, PMTair, Royal Khmer Airlines, Singapore Airlines, Thai Airways International, Nok Tiger Airways, Vladivostok Air, Vietnam Airlines
Da Nang International Airport	
	Far Eastern Air Transport, Pacific Airlines, PBair, Singapore Airlines,SilkAir, Vietnam Airlines
Tan Son Nhat International Airport	
	Air China, Air France, All Nippon Airways, Asiana Airlines, Bangkok Airways, Cathay Pacific, Cargolux, China Airlines, Mandarin Airlines, China Airlines Carg China Eastern Airlines, China Southern Airlines, EVA Air, Uni Air, Finnair, Garuda Indonesia, Hong Kong Airlines, Japan Airlines, Jetstar Asia Airways, KLM, Korean Air, Korean Air Cargo, Lufthansa, Malaysia Airlines, Pacific Airlines, Philippine Airlines, Qantas, Jetstar Airways, Qatar Airways, Royal Brunei Airline Royal Khmer Airlines, Shanghai Airlines, Shanghai Airlines Cargo, Shenzhen Airlines, Singapore Airlines, Thai Airways International, Tiger Airways,Transaerc United Airlines, Vietnam Airlines, Viva Macau

Source: Various sources on the WWW.

countries have shown good examples of how to overcome this constraint since the middle of the 20th century. Economic zoning, ranging from providing a mere tract of land to a full package estate, is a good scheme of attracting investment into a geographical area. In most cases, the chosen site not only provides good access to facilities and administrative services but also gives investment incentives. These generally consist of reduced set-up costs and easier mobility for investors. Many kinds of economic zoning from export processing zone to industrial park, free port, and free zones in ASEAN are plotted in Figure 2.

Figure 2. Concentration of Industrial Parks in ASEAN (Including Planned)



Source: Drawn by author based on statistics at ASEAN-Japan Centre's Home Page (http://www.asean.or.jp/eng/).

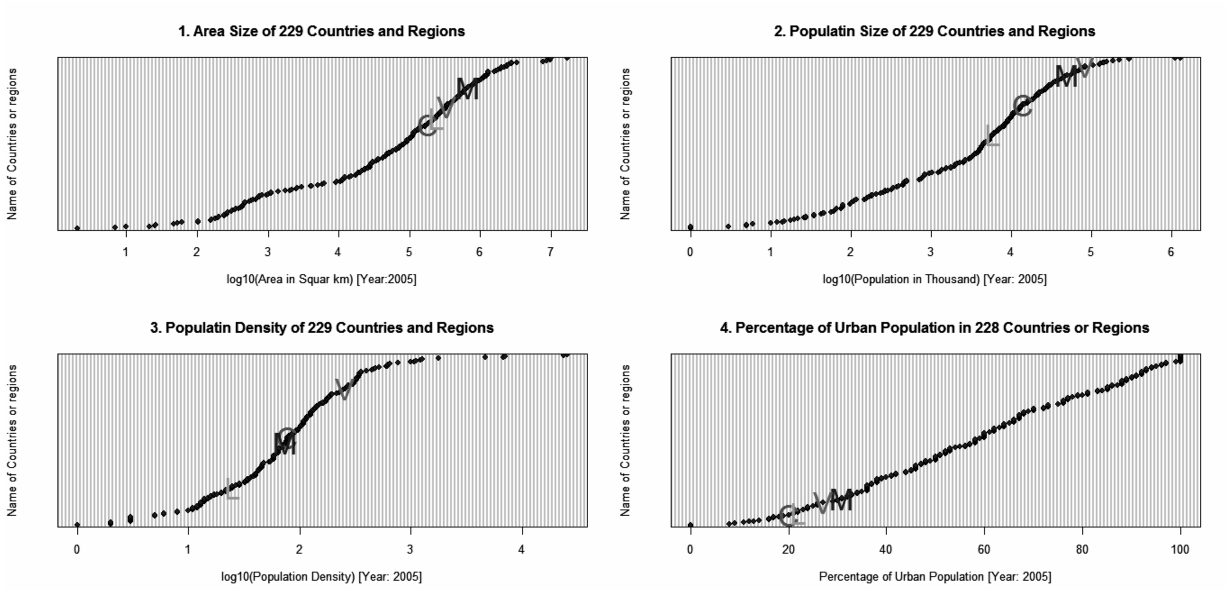
Larger concentrations of economic zones are seen in more industrialized ASEAN countries such as Singapore, Malaysia, Thailand, and Philippines. However, a number of these facilities can also be found in relatively small city-states such as Brunei. For CLMV, a certain number of economic zoning facilities are seen in growth centers of Vietnam both in the north and in the south. While Cambodia has small concentrations of industrial parks in coastal areas, Laos has only two planned sites. There are about 50 various types of industrial estates throughout Myanmar.

4. SUPPLY AND DEMAND FACTORS

As pointed out earlier, this report added supply and demand factors to the general definitions of investment climate. Figure 3.1 to 3.4 depicts land areas, population sizes, population densities, and percentages of urban population in 229 countries and regions around the globe. These were selected to demonstrate some of the potential supply factors for investment activities within these territories.

In Figure 3.1, CLMV are on the top half, meaning that more than half of 229 countries and regions in the world have areas smaller than CLMV. Myanmar has the largest area among countries in the Indochinese peninsula. Vietnam is on the top third among the 229 territories because of its land area which is even larger than Japan. Despite its small population, Laos is larger than many states in the European Union (EU). Cambodia is the smallest in terms of land area but still larger than more than half of 229 territories presented in Figure 3.1.

Figure 3: Supply Factors



Source: Drawn by author based on statistics available at United Nation Statistics Division's Home Page (http://unstats.un.org/unsd/default.htm).

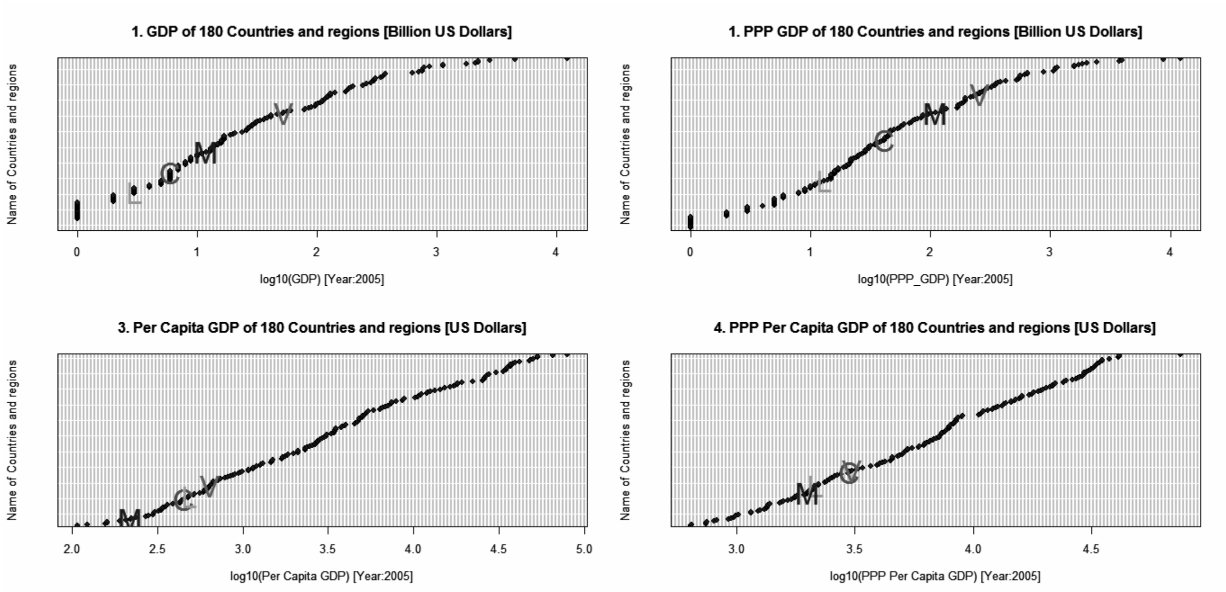
It is also worth noting that while larger areas do not necessary lead to more natural resources, most of these resources are in fact under land or sea. CLMV have actually entered into the era of modern or large-scale commercial exploration of natural resources since the late 1990s. PetroVietnam's annual export of crude oil reached US$4 billion in the first several months of 2007. Myanmar's export of natural gas to Thailand jumped from several hundred thousands in 1997 to more than US$2 billion in 2006. Laos began its commercial export of gold in 2003, and the total export value of gold and copper reached more than US$500 million in 2006. The commercial export of oil under exploration off the Cambodian shore is expected in 2010. More natural gas mines and gold mines are being developed in Myanmar and Laos, respectively, while crude oil export from Vietnam is likely to continue increasing. In CLMV, natural resources are therefore one of the attractive sectors to invest in.

In terms of population, besides China and India (represented by two dots in Figure 3.2) that have more or less than one billion population each, there are not many countries in the world that have a population much larger than Vietnam (more than 84 million). Myanmar's population is around 50 million. It is followed by Cambodia with more than 14 million and by Laos with nearly 6 million. While Laos' population is extremely small by ASEAN's standard, it is actually bigger than many industrialized states in the EU.

Density is also important when it comes to population. Industrial agglomeration will not be possible without agglomeration of population as labor cannot pay higher so people can travel to their place of work. Figure 3.3 reveals that the population density in Vietnam is high by global standard. Cambodia and Myanmar are in the middle while Laos has one of the lowest population densities in the world. The population density of Laos is significantly low because while its population is larger than Singapore and a little smaller than Hong Kong (China), two of the most industrialized states in Southeast Asia, its land area is nearly 342 times larger than that of Singapore. Mobilization of labor force would likely be necessary if Laos is to move forward with the improvement of investment climate, especially for the manufacturing sector.

As can be gleaned from Figure 3.4, the urbanization level in CLMV is still in its early stages. The percentage of urban population in Cambodia and Laos is around 20 percent; in Myanmar and Vietnam, the figure is around 30 percent. This may be a reflection of the stage of industrialization in these countries as well as the potential of work force mobilization in the face of industrialization.

Figure 4: Demand Factors



Source: Drawn by author based on statistics available at United Nation Statistics Division's Home Page (http://unstats.un.org/unsd/default.htm).

Figure 4.1 to 4.4 reveal the indicators of CLMV as potential markets among economies in the world. Based on Figure 4.1, the GDP of Vietnam is in the bottom top half of 180 countries or regions. Vietnam's economy is still smaller than all former members of ASEAN, but the largest among CLMV. With their combination of large population and small per capita income, Vietnam and Myanmar are certainly by far more attractive in terms of a single market compared to Cambodia and Laos.

Per capita incomes of CLMV are low or among the lowest in the world as can be seen in Figures 4.3 and 4.4. While this spells CLMV's high potential to supply cheap labor, it also lowers their attractiveness as markets at present.

Although the population sizes of CLMV can be considered both supply and demand factors of investment climate, the supply and demand factors of these countries are not necessarily equal. With the ongoing trend in reduction of transportation costs, development of transportation technologies, and emerging regional integration around the world, the accessible markets for investment activities within a territory are usually larger than just a domestic market. For CLMV, many efforts within several frameworks, such as ASEAN, Great Mekong Subregion Program (Asian Development Bank), and Ayeyawady-Chao Phraya-Mekong Economic Cooperation Strategy, are all aiming at, or at least moving in, the direction of creating a single market. Therefore, for both Cambodia and Laos, where domestic markets are relatively small, but are sandwiched or surrounded by much larger and growing economies such as Thailand, Vietnam, other ASEAN members, and even China, the accessible market for investment in both countries may be several times bigger than their domestic markets.

In short, among CLMV, the supply and demand factors of Myanmar and Vietnam are good even by international standard, while Cambodia and Laos can also be attractive if certain conditions are met.

5. POLICY FACTORS

Tax regimes, governance issues, and government policies or actions that affect the investment climate can be considered as policy factors. However, making a comparison of such factors based on statistics across countries in the world would be extremely difficult. Indexing them would require large funds, time, and manpower for both surveys and analyses.

This report, instead, makes use of the Doing Business Index compiled by World Bank, which encompasses mainly policy factors across countries. The index is composed of 10 detailed indices or rankings, namely, (1) start a business, (2) dealing with licenses, (3) employing worker, (4) registering property, (5) getting credit, (6) protecting investors, (7) paying taxes, (8) trading across border, (9) enforcing contracts, and (10) closing a business.

Start a business index ranks the easiness of starting a business in a country or region based on (1) number of procedures, (2) time (days), (3) cost, and (4) minimum capital as percentage of per capita income. Table 4 shows CLV scores in the start a business index. There are more or less 10 procedures to start a business in CLV compared to 2 to 20 procedures in other countries. However, in term of time to start a business, more than five months are needed in Laos, nearly three months in Cambodia, and more than one and a half months in Vietnam. The time needed to start a business in Cambodia and Laos is many times longer than the world average (47.7 days). Vietnam is close to achieving the world average, better than Indonesia's 97 days, almost the same as the Philippines' 48 days, but 20 days longer than Malaysia's 30 and Thailand's 33 days and far behind Singapore's six days and Australia's best practice of two days.

Minimum capital (as percent of per capita GDP) necessary to start a business is generally low in ASEAN. However, more than half of per capital GDP is required in Cambodia and ASEAN. This may not be problem for large scale or foreign investment, but it is certainly a huge barrier for lower classes.

The processes comprising the start a business index can be taken as the beginning of investment itself and therefore no benefit from investment may be achieved if investors cannot pass through them.

Licensing is one of the main obstacles in doing business in many developing countries. The time and cost associated with obtaining licenses are high, and unpredictable in many cases. The dealing with licenses index includes (1) number of procedures, (2) time (days), and (3) cost (as percentage of per capita income). Table 5 provides CLV's scores for said index focusing on the construction sector in the individual countries. Sierra Leone (Africa) has the most number of procedures (48) to obtain business licenses. Cambodia has 28; Laos, 24; and Vietnam, 14. The best practice is found in Denmark with 7 procedures. Singapore, which was ranked overall as the most friendly environment for doing business according to the dealing with licenses index, has 11 procedures.

Table 4: Start a Business Index [2006]

Economy	Rank_All	Rank	Procedures (number)	Time (day)	Cost (% per capita GDP)	Minimum Capital (% per capita GDP)
Cambodia	143	159	10	86	236.4	66.2
Lao PDR	159	73	8	163	17.3	0
Vietnam	104	97	11	50	44.5	0
Indonesia	135	161	12	97	86.7	83.4
Malaysia	25	71	9	30	19.7	0
Philippines	126	108	11	48	18.7	1.8
Singapore	1	11	6	6	0.8	0
Thailand	18	28	8	33	5.8	0
Australia	8	2	2	2	1.8	0
Canada	4	1	2	3	0.9	0
Denmark	7	14	3	5	0	44.6
New Zealand	2	3	2	12	0.2	0

Source: Doing Business 2007.

The time necessary to deal with business licenses is about 4 to 6 months in CLV, a little shorter than the world average of nearly 7 months. The best practice is Korea's 52 days. The cost of dealing with licenses in Cambodia, which is equal to 1640.5 percent of per capita income is, however, extremely high, and lower than only a few countries that are mostly in Africa. This figure is 204.1 percent in Laos and 56.4 percent in Vietnam.

Table 5: Dealing with Licenses Index [2006]

Economy	Rank_All	Rank	Procedures (number)	Time (day)	Cost (% per capita GDP)
Cambodia	143	159	28	181	1,640.50
Lao PDR	159	130	24	192	204.1
Vietnam	104	25	14	133	56.4
Indonesia	135	131	19	224	311
Malaysia	25	137	25	281	78.2
Philippines	126	113	23	197	113.4
Singapore	1	8	11	129	22
Thailand	18	3	9	127	11.1
St. Vincent and the Grenadines	44	1	11	74	10.6
Denmark	7	6	7	70	67.8
South Korea	23	28	14	52	175.9
Palau	62	42	23	114	6.8

Source: Doing Business 2007.

The employing worker index was derived from examining government regulation in the area of employment and social security. The index consists of (1) rigidity of employment index, (2) nonwage labor cost (% of salary), and (3) firing costs (weeks of wages). The rigidity of employment index is divided further into (1) difficulty of hiring index, (2) rigidity of hours index, and (3) difficulty of firing index.

Since employment and social security are decided to protect workers, it is difficult to determine whether rigid or not rigid regulations are better for both employers and employees. Therefore, the term “best practice” may not be suitable in this category. The indices in Table 6 should instead be taken as barometer of rigidity of employment and social security in a certain country.

Among countries in ASEAN, regulations regarding employment and social security are not so rigid in Laos, Vietnam, Singapore, and Malaysia. They are more rigid in Cambodia, Indonesia, Philippines, and Thailand. On the other hand, nonwage salary cost is almost 0 in Cambodia while it ranges from 5 to about 10 percent of salary for the rest in ASEAN. Among CLV, firing cost is highest in Vietnam and least in Cambodia and Laos.

Table 6: Employing Worker Index [2006]

Economy	Rank All	Rank	Difficulty of Hiring Index	Rigidity of Hours Index	Difficulty of Firing Index	Rigidity of Employment Index	Nonwage labor cost % salary	Firing costs Weeks of wages
Cambodia	143	124	56	60	30	49	0	39
Lao PDR	159	71	11	40	60	37	5	19.4
Vietnam	104	104	0	40	70	37	17	86.7
Indonesia	135	140	61	20	50	44	10	108.3
Malaysia	25	38	0	20	10	10	12.8	88
Philippines	126	118	56	40	20	39	8.5	91
Singapore	1	3	0	0	0	0	13	4
Thailand	18	46	33	20	0	18	5.2	54.3
Marshall Islands	87	1	0	0	0	0	10.5	0
Australia	8	9	0	0	10	3	21.3	4
Hong Kong	5	16	0	0	0	0	5	62.1
Maldives	53	5	0	0	0	0	0	8.7
Tonga	51	4	0	20	0	7	0	0

Source: Doing Business 2007.

According to statistics from Doing Business 2007, land and building account for between half and three quarters of the wealth of most economies. Registering them has been proven advantageous for entrepreneurs. The registering of property index is composed of (1) number of procedures, (2) time (days), and (3) cost (% of property value). These indices are based on the standard case of an entrepreneur wanting to purchase land and building in the largest business city in each economy.

In Laos, it takes more than four months to process nine procedures and the cost of registration is 4.2 percent of the value of the property to be registered. In Cambodia, the registration time is less than two months for seven procedures and the cost is 4.6 percent of the value of the property to be registered. The cost of registration is relatively low in Vietnam at only 1.2 percent of the value of the property and the number of procedures is less at 4 but processing time is still about two months.

Table 7: Registering Property Index [2006]

Economy	Rank All	Rank	Procedures (number)	Time (day)	Cost (% property value)
Cambodia	143	100	7	56	4.6
Lao PDR	159	148	9	135	4.2
Vietnam	104	34	4	67	1.2
Indonesia	135	120	7	42	10.5
Malaysia	25	66	5	144	2.4
Philippines	126	98	8	33	5.7
Singapore	1	12	3	9	2.8
Thailand	18	18	2	2	6.3
New Zealand	2	1	2	2	0.1
Norway	9	6	1	1	2.5
Saudi Arabia	38	4	4	4	0

Source: Doing Business 2007.

Firms consistently rate access to credit as one of the greatest barriers to their operation and growth (Doing Business 2007). The getting credit index is composed of (1) legal right index, (2) credit information index, (3) public registry coverage (% adults), and (4) private bureau coverage (% adults). The strength of legal rights index measures 10 aspects of the rights of borrowers and creditors in collateral and bankruptcy laws, including whether:

- General rather than specific description of assets and debt is permitted in collateral agreements;
- Any legal or natural person may grant or take security in assets;
- A unified registry operates that includes charges over movable property;
- Secured creditors have priority both within bankruptcy and outside it;
- Parties may agree on out-of-court enforcement of collateral by contract; and
- Creditors may both seize and sell collateral out of court, no automatic stay or "asset freeze" applies upon bankruptcy, and the bankrupt debtor does not retain control of the firm.

Table 8: Getting Credit Index [2006]

Economy	Rank All	Rank	Legal Rights Index	Credit Information Index	Public registry coverage (% adults)	Private bureau coverage (% .adults)
Cambodia	143	174	0	0	0	0
Lao PDR	159	173	2	0	0	0
Vietnam	104	83	4	3	2.7	0
Indonesia	135	83	5	2	8.4	0.2
Malaysia	25	3	8	6	42.2	
Philippines	126	101	3	3	0	4.8
Singapore	1	7	9	4	0	38.6
Thailand	18	33	5	5	0	21.7
United Kingdom	6	1	10	6	0	86.1
Hong Kong	5	2	10	5	0	64.5
Japan	11	13	6	6	0	
Portugal	40	65	4	4	72	9.1
Argentina	101	48	3	6	25.4	100

Source: Doing Business 2007.

Data were obtained by examining collateral and bankruptcy laws and legal summaries, and verified through a survey of financial lawyers (Doing Business 2007).

According to scores in Table 9, legal rights in CLV are still weak. They are 0 in Cambodia, 2 in Laos, and 4 in Vietnam, all less than 5 in the range from 0 to 10. Among former member of ASEAN, only Malaysia (8) and Singapore (9) score higher than 5.

The credit information index measures the extent to which the rules of a credit information system facilitate lending based on the scope of information distributed, the ease of access to information, and the quality of information. The score of Cambodia and Laos is both 0. Vietnam's score is 3, which is higher than Indonesia's, the same as the Philippines', and close to Singapore's score.

Public and private registry coverage refers to the number of individuals and firms covered by public and private registry. They are both 0 in Cambodia and Laos. For Vietnam and the rest of ASEAN, the strategy can be obviously divided into two types.

While Vietnam, Indonesia, and Malaysia try to cover this by public registry, these are left mainly to the private sector in the Philippines, Singapore, and Thailand.

If the rights of investors are not protected, having the majority share in the ownership of a business is the only way to eliminate expropriation. But then, investors must devote more oversight attention to fewer investments resulting in entrepreneurship being suppressed (Doing Business 2007).

The protecting investor index is composed of (1) disclosure index, (2) director liability index, (3) shareholder suits index, and (4) investor protection index. Out of 175 economies, Laos and Vietnam are both ranked 170 while Philippines is ranked 151. Cambodia is ranked 60, the same as Indonesia. Singapore and Malaysia are ranked 2 and 4, respectively.

Table 9: Protecting Investor Index [2006]

Economy	Rank All	Rank	Disclosure Index	Director Liability Index	Shareholder Suits Index	Investor Protection Index
Cambodia	143	60	5	9	2	5.3
Lao PDR	159	170	0	3	3	2
Vietnam	104	170	4	0	2	2
Indonesia	135	60	8	5	3	5.3
Malaysia	25	4	10	9	7	8.7
Philippines	126	151	1	2	7	3.3
Singapore	1	2	10	9	9	9.3
Thailand	18	33	10	2	6	6
New Zealand	2	1	10	9	10	9.7
Hong Kong	5	3	10	8	9	9
New Zealand	2	1	10	9	10	9.7

Source: Doing Business 2007.

The paying tax index consists of (1) payments (number), (2) time (hour), (3) profit tax, (4) labor tax and contributions, (5) other taxes, and (6) total tax rate. Cambodia and Laos are ranked 16 and 36, respectively, in this index, and are between Singapore in rank 8 and Indonesia in rank 133 in ASEAN. Vietnam is ranked 120, much lower than Cambodia and Laos mainly due to the time necessary in paying tax. Time in hours necessary to pay tax in Vietnam is 1,050, which is clearly longer than the time in Laos (180) and Cambodia (121)

The trading across border index consists of (1) documents for export (number), (2) time for export (days), (3) cost to export (US$ per container), (4) documents for import (number), (5) time for import (days), and (6) cost to import (US$ per container).

Laos is among the countries where trading across border is most difficult. It is ranked 161 out of 175 economies, while Cambodia and Laos are ranked 114 and 75, respectively. The costs to import (U$1,420) and export (U$1,690) in Laos are nearly two times higher than those in Cambodia and Vietnam.

Table 10: Paying Tax Index [2006]

Economy	Rank All	Rank	Payments (number)	Time (hour)	Profit tax	Labor tax and contributions	Other taxes	Total tax rate
Cambodia	143	16	27	121	19.6	0	2.7	22.3
Lao PDR	159	36	31	180	26.7	5.8	0	32.5
Vietnam	104	120	32	1,050	21.6	19.7	0.2	41.6
Indonesia	135	133	52	576	25.2	11.3	0.6	37.2
Malaysia	25	49	35	190	17.7	15.8	1.6	35.2
Philippines	126	106	59	94	22.7	10.6	19.7	53
Singapore	1	8	16	30	12	14.8	2	28.8
Thailand	18	57	46	104	29.2	6	5	40.2
Maldives	53	1	1	0	0	0	9.3	9.3
Saudi Arabia	38	6	14	75	2.1	12.8	0	14.9

Source: Doing Business 2007.

Table 11: Trading Across Border Index [2006]

Economy	Rank All	Rank	Documents for export (number)	Time for export (days)	Cost to export (US$ per container)	Documents for import (number)	Time for import (days)	Cost to import (US$ per container)
Cambodia	143	114	8	36	736	12	45	816
Lao PDR	159	161	12	66	1,420	16	78	1,690
Vietnam	104	75	6	35	701	9	36	887
Indonesia	135	60	7	25	546	10	30	675
Malaysia	25	46	6	20	481	12	22	428
Philippines	126	63	6	18	1,336	7	20	1,336
Singapore	1	4	5	6	382	6	3	333
Thailand	18	103	9	24	848	12	22	1,042
Hong Kong	5	1	2	5	425	2	5	425
Estonia	17	6	5	3	640	6	5	640
Tonga	51	17	6	12	265	9	17	360

Source: Doing Business 2007.

Where contract enforcement is efficient, businesses are likely to engage with new borrowers or customers (Doing Business 2007). The enforcing contract index is based on the efficiency of the judicial system to resolve a commercial dispute. The index consists of (1) procedures (number), (2) time (days), and (3) cost (% of debt).

As can be read in Table 12, it takes more than a year to resolve a business dispute in Cambodia and Laos, and nearly 10 months in Vietnam. It costs 20 percent more than the cost of the debt itself in Cambodia. Making processing time shorter and less costly is certainly what an economy can do to improve its rank in this index. Time and cost are, however, still high in most of the ASEAN except for Singapore with 120 days and 14.6 percent.

Table 12: Enforcing Contract Index [2006]

Economy	Rank All	Rank	Procedures (number)	Time (days)	Cost (% debt)
Cambodia	143	118	31	401	121.3
Lao PDR	159	146	53	443	30.3
Vietnam	104	94	37	295	31
Indonesia	135	145	34	570	126.5
Malaysia	25	81	31	450	21.3
Philippines	126	59	25	600	16
Singapore	1	23	29	120	14.6
Thailand	18	44	26	425	17.5
Denmark	7	1	15	190	6.5
Iceland	12	8	14	352	5.9
New Zealand	2	15	28	109	10.9
Korea	23	17	29	230	5.5

Source: Doing Business 2007.

Lastly but equally important is the closing a business index. The economic crises of the 1990s in emerging markets—from East Asia to Latin America, from Russia to Mexico—raised concerns about the design of bankruptcy systems and the ability of such systems to help reorganize viable companies and close down unviable ones (Doing Business 2007). In countries where the bankruptcy system is inefficient, unviable businesses linger for years, keeping assets and human capital from being reallocated to more productive uses (Doing Business 2007). The closing business index consists of (1) time (years), (2) cost (% of estate), and (3) recovery rate (cents on the dollar).

Judging from Table 13, it is difficult to close a business in CLV. Cambodia and Laos are both ranked 151 while Vietnam is ranked 116 out of 175 economies. Recovery rate is 0 in Cambodia and Laos, and 18 cents on a dollar in Vietnam. The processing time is five years in Laos and Vietnam, a little shorter than Indonesia’s 5.5 years, Philippines’ 5.7 years, and clearly much longer than Singapore’s 0.8 years.

Table 13: Closing a Business Index [2006]

Economy	Rank All	Rank	Time (year)	Cost (% estate)	Recovery rate (cents on the dollar)
Cambodia	143	151			0
Lao PDR	159	151	5	76	0
Vietnam	104	116	5	14.5	18
Indonesia	135	136	5.5	18	11.8
Malaysia	25	51	2.3	14.5	38.7
Philippines	126	147	5.7	38	4
Singapore	1	2	0.8	1	91.3
Thailand	18	38	2.7	36	42.6
Japan	11	1	0.6	3.5	92.7
Ireland	10	7	0.4	9	87.9
Singapore	1	2	0.8	1	91.3
Eritrea	170	151	1.7	14.5	0

Source: Doing Business 2007.

6. CONCLUSION REMARKS

This paper attempted to identify the investment climates in CLMV. First, it re-arranged investment climates into (1) macroeconomic factors, (2) infrastructures, (3) supply and demand factors, and (4) policy factors. Then, it tried to reveal CLMV's position for each factor by making a comparison across as many economies as possible using statistics and indices made available by international institutions and national statistical authorities mainly in CLMV.

Utilizing data from several sources is, in itself, a limitation of this report. While this made comparison across wider topics and economies possible, ensuring consistency in degree and scope and accuracy of statistics and data from different sources proved to be difficult. Despite this constraint, however, the report was able to arrive at a number of conclusions.

According to statistics, the macroeconomic factors in CLMV can be considered stable in general since the beginning of the 21st century, with a few exceptions. Firstly, Cambodia and Laos are still heavily dependent on external aid. The sudden stoppage of aid can lead to extremely unstable macroeconomic conditions. Secondly, Lack of statistics and very large gaps between information from different sources in the case of Myanmar, and to less extent Cambodia, Laos and Vietnam, have made it difficult or impossible to accurately evaluate their macroeconomic factors.

Among CLMV, supply factors, especially in terms of labor, are much better in Myanmar and Vietnam due to their huge population sizes. The situation is better in Cambodia than in Laos, because while the population size of Cambodia is only about three times that of Laos, the higher population density has made the location of labor-intensive industries more viable in Cambodia. On the other hand, supply factors in terms of natural resources are getting better recently for all CLMV, due to successful commercialization of exploitation of different resources in different countries.

There is, however, plenty of room for improvement in both infrastructure and policy factors in CLMV. For infrastructure factors, sufficient roads and railway networks are yet to be developed in Cambodia and Laos, while improvement and better administration are still necessary in Myanmar and Vietnam. This also holds for policy factors, where Cambodia (143), Laos (159), and Vietnam (104) are still ranked lower than 100 out of 175 economies according to Doing Business 2007.

Providing better investment climates evenly throughout an economy may be considered ideal but, in reality, it is often difficult or not possible due to many resource limitations including finance. One way to overcome this may be through economic zoning. Economic zoning, which ranges from providing a mere tract land to a full package estate, may make it possible to provide better investment climates within a certain (smaller) geographical area, with relatively limited resources. This has been proven practical and effective as a tool for industrialization by many newly industrializing economies in Asia, former ASEAN members, as well as China during the mid to late 20th century

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Chapter 6

CHINA'S TRADE AND ECONOMIC RELATIONS WITH CLMV

Hao Hongmei

ABSTRACT

This chapter aims to analyze China's trade and economic relations with Cambodia, Laos, Myanmar, and Vietnam (CLMV) and gives an objective evaluation of China's policy (existing and future) on regional economic cooperation, in particular, on China's impacts on CLMV's development. The paper also tries to provide an answer--or at least way of thinking--to the question: How will CLMV share in China's high-gear economic growth and follow up the regional economic integration?

1. CHINA'S TRADE AND ECONOMIC RELATIONS WITH CLMV

1.1 Bilateral trade

1.1.1 Status quo of trade performance in recent years

Cambodia, Laos, Myanmar, and Vietnam (CLMV) are China's neighbors in the southwest, all of which have good relations with China. Bilateral trade between China and CLMV has been growing rapidly in recent years, where China has an overall trade surplus with the four countries, although it suffers deficits with the ASEAN as a whole.

In 2006, the China-CLMV trade was US$12.4 billion, which increased 584.8 percent from that of 1995. China-Cambodia trade increased 1,178.9 percent from US$57.3 million in 1995 to US$732.8 million in 2006. China-Vietnam trade in 2006 shared 78.3 percent of total China-CLMV trade and increased by 973.8 percent from US$927.0 million in 1995 to US$9,954.2 million in 2006. China-Laos trade increased 302.0 percent from US$54.3 million in 1995 to US$218.3 million in 2006.

China-Myanmar trade rose 90.3 percent from US$767.3 million in 1995 to US$1,459.9 million in 2006.

China had a surplus in its trade with CLMV. The surplus in 1995 was US$818.4 million, which accounted for 45.3 percent of the total trade between China and CLMV. The surplus in 2006 was US$6,718.7 million, accounting for 54.3 percent of the total China-CLMV trade in the year.

Table 1: China's Trade with CLMV (1995-2006)

(US$ million)

	China-CLMV Trade	Change (%)	Export to CLMV	Import from CLMV	Balance
1995	**1805.8**	**-**	**1312.1**	**493.7**	**818.4**
Cambodia	57.3	-	51.6	5.7	45.9
Laos	54.3	-	47.8	6.5	41.3
Myanmar	767.3	-	617.8	149.5	468.3
Vietnam	927.0	-	594.9	332.1	262.8
2006	**12365.3**	**584.8**	**9542.0**	**2823.3**	**6718.7**
Cambodia	732.8	1178.9	697.7	35.1	662.6
Laos	218.3	302.0	168.7	49.6	119.1
Myanmar	1459.9	90.3	1207.2	252.7	954.5
Vietnam	9954.2	973.8	7468.3	2485.9	5162.4

Source: China Customs.

China's exports to CLMV are mainly machinery, iron and steel, and textiles. In 2006, China's export of textiles, footwear, and textile materials to Cambodia were valued at US$454.7 million, accounting for 65.2 percent of China's total export to the country. Machinery and vehicles are China's major exports to Vietnam, Myanmar, and Laos. In 1995, China's export value of these products to Vietnam was US$196.6 million, which was 27.3 percent of the total export in the year. In 2006, China's machinery and vehicles exports to Vietnam increased to US$1,859.2 million, 9.4 times that in 1995, whereas the share fell to 24.9 percent in 2006. Currently, China's agricultural machinery (walking tractor, diesel engine) accounts for over 90 percent in Myanmar's market.

Table 2: Composition of China's Exports to CLMV, 2006

(US$ million)

HS	Description	Value	Share %
	Vietnam	7468.3	10.5
72	Iron And Steel	1346.7	18
84	Machinery	959.0	12.8
27	Mineral Fuel, Oil, Etc	791.2	10.6
	Myanmar	1207.2	1.7
84	Machinery	156.6	13
72	Iron And Steel	115.3	9.6
27	Mineral Fuel, Oil, Etc	113.9	9.4
	Cambodia	697.7	1
60	Knit,Crocheted Fabrics	207.6	29.8
52	Cotton+Yarn,Fabric	115.1	16.5
84	Machinery	53.2	7.6
	Laos	168.7	0.2
87	Vehicles, Not Railway	39.3	23.3
85	Electrical Machinery	34.7	20.6
88	Aircraft, Spacecraft	30.8	18.3

Source: China Customs.

On the other hand, China's imports from CLMV are mainly raw materials. Minerals fuels are China's major imports from Vietnam; however, its share in China's total imports from the country declined in recent years---from 69.7 percent in 2004 to 65.2 percent in 2005 and 42.7 percent in 2006. Meanwhile, China's imports of rubber from Vietnam grew markedly; such product's share in total imports grew from 6.6 percent in 2005 to 13.3 percent in 2006. Bilateral trade between China and Vietnam is targeted to reach US$15 billion in 2010. In the coming years, China's imports of coffee and rubber from Vietnam will increase by a big margin. In 2006, its import demands for Vietnam's coffee, tea, and rubber was US$100 million, US$50 million and US$2.8 billion, respectively. In comparison, the actual imports of the three products from Vietnam were only US$13 million, US$7 million and US$773 million, respectively.

Here, one sees a fairly large gap between demand and actual import. Finally, wood enjoys absolute predominance in China's imports from Myanmar, Laos, and Cambodia.

Table 3: Composition of China's Imports from CLMV, 2006

(US$ million)

HS	Description	Value	Share %
	Vietnam	2485.9	2.8
27	Mineral Fuel, Oil Etc	1061.9	42.7
40	Rubber	331.6	13.3
26	Ores, Slag, Ash	179.3	7.2
	Myanmar	252.7	0.3
44	Wood	152.2	60.3
40	Rubber	21.4	8.5
26	Ores, Slag, Ash	16.7	6.6
	Laos	49.6	0.1
44	Wood	23.3	46.9
40	Rubber	12.1	24.4
74	Copper+Articles Thereof	4.2	8.4
	Cambodia	35.1	0
44	Wood	12.1	34.4
40	Rubber	8.7	24.8
52	Cotton+Yarn, Fabric	6.8	19.3

Source: China Customs.

Rubber is another of China's major imports from CLMV. China's demands for this product will continue to rise due to its rapid industrial expansion. China recorded an annual growth rate of 22.4 percent from 2000-2005 in its automobile production. Therefore, the CLMV should take advantage of their proximity to China and expand their rubber exports to the nation. The surging rubber price in international market will, to some extent, help to reduce the trade deficits with China.

1.1.2 Analysis of CLMV's trade dependence on Chinese market

Although CLMV's trade with China remains small in absolute value, its import dependence on the Chinese market is relatively high. Myanmar depends heavily on trade with China while Vietnam's dependence is to a lesser extent because of the latter's better-developed trade relations with the rest of Asia and the industrialized countries. If cross-border informal trade is included, the figure would be even larger.

Table 4: CLMV's Trade Dependence on China, 2006

(US$ million)

	Exports			Imports		
	Value	To China	Share %	Value	From China	Share %
Cambodia	2602.4	35.1	1.4	2174.0	697.7	32.1
Laos.	254.7	49.6	19.5	423.6	168.7	39.8
Myanmar	3514.8	252.7	7.2	2115.5	1207.2	57.1
Vietnam	39605.0	2485.9	6.3	44410.0	7468.3	16.8

Source: China Customs, http://www.aseansec.org/stat/Table17.xls

Table 5: Comparison of CLMV's Import Dependence on China, 2001-2006

	2001	2002	2003	2004	2005	2006
Cambodia	13.5	12.7	17.2	14.3	18.9	32.1
Laos.	10.2	12.6	18.8	19.9	22.6	39.8
Myanmar	21	31.2	34.9	42.3	53.7	57.1
Vietnam	11.6	11.3	12.8	13.7	15.5	16.8

Source: China Customs, Aseansec (2006), WTO (2001-2005)

Data show that CLMV's dependence on the Chinese market is increasing. China's dependence on CLMV's raw materials will also increase in the future, but since China is a big country, it has other sources of imports. Due to China's industrial structure and huge domestic market, CLMV is more fragile in terms of trade.

There is, however, potential for more Chinese exports to CLMV in the future. This is because of the following:

- Favorable political climate between China and CLMV
- China's low-wage and competitive manufacturing sectors
- Geo-advantage, in particular, China's southwest region
- Lower tariffs
- Regional and sub-regional trade and investment facilitation in which China and

CLMV are members of.

On the whole, China has a relatively complete industrial structure, and can make most commodities by itself and of better quality than those of CLMV. There are at least two challenges facing China-CLMV trade relations in the future. One is how, how fast, and how much more the Chinese market can take of CLMV's products The answer to this will partly determine the soundness of the China-CLMV trade relations. There is little room for import tariff reduction since most products already enjoy zero tariff. However, to become a big power in the world economic system, China has to show its ability in taking in CLMV's products and letting them feel the real interests in strengthening the trade cooperation. The Chinese government has noticed the problem of increasing trade surplus with CLMV amid the rapid development of bilateral trade, and it is possible measures will be taken to reduce the trade imbalance.

The second challenge is how to solve the problem of a similar industrial structure among these nations. According to the report issued by the US International Trade Commission, the competitiveness of Vietnam's textiles is second only to China, and its target markets are also the United States, European Union, and Japan. Meanwhile, Vietnam also enjoys a lower cost of labor. Therefore, trade disputes in the future are likely to occur. China is now stepping up its efforts to move from an export-oriented and extensive growth strategy in its foreign trade, but instant results will not be abruptly produced. Labor-intensive products will still be the mainstay for China's exports over a longer period of time. With this awareness, China will try to avoid the areas where they compete with CLMV's local companies and choose to trade more in areas that are mutually complementary such as raw materials.

1.1.3 China's foreign trade policy during 2006-2010 and possible impacts on CLMV

China's 11th Five-year Plan (2006-2010) will bring its economy into a new phase of steady growth. China's annual GDP growth is estimated at above 8 percent, while the total retail sales of consumer goods and production factors will reach around US$4.8 trillion by 2010.

During the 11th Five-year Plan Period, China's merchandise imports and exports will reach US$2,500 billion to US$2,700 billion in value terms. With a growth of around 15 percent, a roughly balanced trade position will be achieved.

Starting 2006, the Chinese government has made drastic adjustments and changes in its trade policy. The general trend is to transit progressively to a neutralized policy framework. Its major policy measures include the following:

- The RMB exchange rate is no longer pegged to the American dollar. China has adopted a managed floating exchange rate regime based on supply and demand;
- Imposition of export duty on high-energy consuming, environmental-harmful and resource-intensive products;
- A lowering of the export rebate rate for high-energy consuming, environmental-harmful and resource-intensive products and some labor-intensive products with lower value added;
- Policy adjustments in processing trade, which prohibited or restrained market access to high-energy consuming, environmental-harmful and resource-intensive products and some products with lower value added;
- Unified income tax of domestic enterprises and enterprises with foreign investment;
- Relaxed restrictions on foreign exchange and eliminated forced exchange settlement system;
- Adjusted import policy, cut-down or eliminated import license or quotas;
- Reduced or exempted import tariff and value-added tax on high-tech products and some resource products, raw materials and spare parts.

As China's economic size expands, the import demand will also increase. China's import would possibly come up to US$1.2 trillion by 2010. The Chinese economy offers abundant business opportunities in its more open market, and this would spur imports of natural resources and intermediate products from CLMV.

1.2 China's outward investment to CLMV

1.2.1 Still in its beginning stage

Mutual investment between China and CLMV is still difficult to achieve mainly due to the latter's weak economic standing. Chinese companies invest in CLMV mainly for three purposes: to ensure a steady and long-term supply of raw materials, to avail of local market potentials, and to keep an eye on the western markets.

By the end of 2006, China made an investment of US$246 million in Vietnam. The 434 (excluding HK) Chinese-invested projects range from heavy industry, light industry, construction, hotel, transport, to catering and tourism. In November 2006, during Chinese President Hu Jintao's visit to Vietnam, the China Southern Power Grid Corporation signed an agreement to invest via a build-operate-transfer (BOT) scheme in the first phase of the coal-burning thermal power plant project in Binh Thuan in the south of Vietnam. The investment totaled US$900 million and is the largest joint venture project of Vietnam. Along with the accelerated process of Two Corridors and One Ring, Vietnam will become a heavyweight choice for China's outward investment.

By the end-September 2006, China's investment stock to Laos totaled US$55.86 million, mainly in the field of service trade, manufacturing, and resource development.

China is the top investor in Cambodia. China's investment in Cambodia concentrates on forest development, timber processing, power, textile, building material, contract engineering, and farm production. In the recent 10 years, 107 Chinese enterprises set up business in Cambodia. Although 28 countries, including the United States and the European Union, have granted a generalized system of preferences to Cambodia, only 20 percent of their enterprises can actually make profit.

On November 29, 2006, China reached an agreement with Cambodia over the Trade and Economic Cooperation Zone in Sihanoukville. The zone covers 2.4 square kilometers and will be jointly established by the China Jiangsu Province and two Cambodian companies.

By the end of 2006, China had 27 investment projects in Myanmar with a total contract value of US$475 million, making China occupy the sixth rank in foreign direct investment (FDI) inflows to Myanmar. In November 2006, during Prime Minister General Soe Win's visit to China, both sides agreed to strengthen their cooperation in power grid and hydropower station.

China's FDI in CLMV is underestimated because of some unregistered FDI flows, so it is difficult to create an accurate picture. On the whole, Chinese investment has achieved better results. For example, in Vietnam, TCL Group has set up a TV factory that aims to produce 500,000 TV sets annually while Lifan Motor has established an assembling factory for products that are already widely known in local markets.

Table 6: China's Investment to CLMV, 2003-2006 (US$10,000)

	2003	2004	2005	2006	Stock by end-2006
Total	285465	549799	1226117	1763397	61648
Cambodia	2195	2952	515	981	10366
Laos	80	356	2058	4804	9607
Myanmar	-	409	1154	1264	16312
Vietnam	1275	1685	2077	4352	25363

Source: China Commerce Yearbook (2007)

Table 7: FDI Inflows to CLMV, 2006 (US$ million).

Country	2006			
	Intra-ASEAN	Extra-ASEAN	Total net inflow	Year-on-year change in FDI net inflow
Cambodia	155.5	327.7	483.2	26.8
Laos	10.6	176.8	187.4	575.8
Myanmar	27.8	115.2	143.0	39.4
Viet Nam	181.9	2,178.1	2,360.0	16.8

Source: http://aseansec.org/stat/

Table 8: China's Contract Engineering and Labor Service in CLMV, 2006

(US$10,000)

	Contract value	Business turnover
Total	7164800	3569497
Cambodia	31470	11381
Laos	36380	15207
Myanmar	30935	28158
Vietnam	269520	59275

Source: China Commerce Yearbook (2007)

1.2.2 Barriers and potentials

The CLMV countries have started to open their economies to the outside world and introduced liberal and attractive foreign investment laws since the late 1980s, but FDI inflows are slow to come due to a lack of infrastructure and an inefficient bureaucracy.

Although the rate of growth appears very impressive, China's investment to CLMV is still made up of small-scale enterprises. That is:

- Most Chinese enterprises that invested in CLMV are small in size and weak in market development. Mainly medium and small companies, they do not have huge funds to operate effectively.
- Although there exists rich natural and human resources, the four countries are in the primary stage of industrialization, the climate for investment and development, including market scale, is limited, and infrastructure is inadequate (i.e., poor roads, power, telecom, and water supply). These can raise the cost of the project. According to the *Handbook of Country Risk* issued by the China Export and Credit Insurance Corporation in 2005, indicators show that Vietnam, Laos, and Myanmar still pose a higher country risk for investors.
- China also lacks in-depth research and rich information of development in CLMV markets.

"Going global" is a major national strategy of the Chinese government. In fact, China's nonfinancial outward investment totaled US$17.6 billion in 2006, a year-on-year increase of 43.8 percent. In the Chinese central government's blueprint, China's overseas investment will hit US$60 billion within the 11th five-year plan period.

China already stands as the world's fourth largest economy and has a sizable foreign exchange reserve. Its urban and rural residents' savings is over RMB 1.4 trillion. Meanwhile, statistics from the Ministry of Commerce of the People's Republic of China (MOFCOM) shows that of the 600 major domestic commodities, 446 have supply exceeding demand. Excessive production exists in hardware, textiles, and electrical household appliances. In addition, avoiding trade barriers is also a factor that motivates the government to exert every effort to promote outward investment.

China now has outward investment capacity in various sectors such as light industry, machinery, textile, and electronics. More important, its outward investment in the resources sector is of long-term strategic significance. Enterprises in China's coastal areas currently face rising costs in labor and raw materials. The CLMV is a good choice for shifting its manufacturing base and expansion. The Chinese government will seriously consider creating a more favorable condition for its "going abroad" strategy by arranging for investment liberalization and facilitation in the Free Trade Area. Because there are characteristic differences across countries and regions, any practical move toward liberalization and facilitation, including liberalizing sectors and the "negative list", will be made and revised flexibly, taking into consideration such differences per country.

From other countries' perspective, the potential inflow of Chinese investments is promising due to the Chinese government's intent to go global, with priority given to its neighbors. In the future, Chinese enterprises will be encouraged to engage in agricultural and forestry resource development, and prospecting and exploitation of minerals.

1.2.3 Policy trends

- For the Chinese government to be able to encourage and help its local enterprises to invest abroad, it has to establish overseas economic cooperation zones. Haier Group, one of China's leading home appliance makers, set up the first economic and trade cooperation zone in Pakistan in November 2006. Similar zones will be established in ASEAN countries, including CLMV, in the coming years with the Chinese government adopting some preferential policies concerning financing, insurance, taxation, entry-exit as well as some nonoperational risks.
- Corporate social responsibility will be highlighted. To gain the local society's wide acceptance and achieve sustained and long-term development, the government will urge local enterprises to improve their sense of social responsibility and temper their focus on seeking maximum short-term profit. This includes actively facilitating localization, providing more benefits to local employment, and participating in local environment protection and poverty relief activities.
- China MOFCOM will provide guidance on foreign investment in industries in different countries and promote investment facilitation.
- There is a need for systematic arrangements for bilateral economic cooperation---i.e., define the sector, project, financing, and cooperative mechanisms through framework agreements between governments.

1.3 Aid and other cooperation

1.3.1 Features of China's aids to CLMV

China's outward aid has three major types:

- Grant aid, mainly for small and medium social welfare projects such as hospitals, schools, low-cost housing, and water supply. Also includes humanitarian aid and personnel training.
- Interest-free loan, mainly for infrastructure and civil facilitation.

- Preferential loan, a kind of mid- and long-term low-interest loan provided by financial institutions designated by the Chinese government.

The gap between preferential interest rates and prime rates will be subsidized by the Chinese government. Preferential loans are mainly provided for joint venture projects between the recipient countries and China, productive projects, or plant and electromechanical equipment made in China. The annual interest rate of China's preferential loan is about 2 percent, with a maturity period of 20 years. Grant element is 40 percent, as compared with 72.3 percent of Japan and over 60 percent of World Bank.

The Ministry of Commerce is in charge of bilateral economic aid, which accounts for 80 percent of China's aid. Multilateral aids and aids in other sectors are managed by the Ministry of Finance, Ministry of Health, Ministry of Agricultural, Ministry of Education, etc. However, the lack of a unified administrative system led to a lack of authoritative and complete statistics on China's foreign aid.

Over the past 50 years, the Chinese government has provided, as far as its capacity allows, all types of assistance to CLMV, covering areas such as industry, agriculture, education, healthcare, transport, broadcasting and communications, hydropower and electricity, and infrastructure. At the same time, it has provided technical assistance and trained a large number of technical and administrative personnel.

China's aid to CLMV countries underwent three stages. The first stage began from 1950 to the early of 1980s, the period when China's foreign policy was focusing on building a coalition with developing countries. According to published data, China's aid to Vietnam alone was US$20 billion (according to the world commodity price) until 1978. The second stage of China's aid is from the 1980s to the mid-1990s. During this period, the policy focus was to develop small- and medium-sized projects to meet local needs. The third stage started from 1995 until the present. The policy focus now is to combine aid with bilateral economic cooperation. In November 2006, the Chinese government announced to write off all government interest-free loans (that matured by the end of 2005) given to least developed countries.

Unlike China's initial aid to CLMV in 1950-1960s, which aimed to support the socialist governments, the focus is now on commerce. China has offered a new model that centers on straight commercial relations and fair market prices without the ideological agenda. In the long term, China hopes that the overture will not only give Chinese companies an edge in the competition for local business, but will also tighten the political relations with those recipient countries. The positive effect of China's aid may be summarized as follows:

- Set up a good image in the world
- Help those countries in self-capacity building
- Win the friendship and trust of these countries
- Foster diversified economic cooperation with these countries. Of China's 50 largest foreign economic companies, two-thirds grew from enterprises that engaged in providing foreign aid. In general, China's aid projects also help to accelerate contract engineering since such is easier to be approved by the local government and people.

The economic and technical cooperation between China and Myanmar began in 1961. China supplied 22 complete plants (e.g., sugar factory, textile mill, stadium, theater, and thermal power plant) as well as technical aid to Myanmar. In February 2006, when Myanmar's prime minister visited China, the Chinese government agreed to provide a US$8.7 million aid and US$200 million worth of loans to Myanmar.

In 1993-2005, China's economic and technical aid (*gratis*, interest-free loans, low-interest loans) to Cambodia totaled RMB 2 billion. China provided training to 294 of Cambodia's government officials and technicians and dispatched 35 experts to Cambodia for technical guidance. In more recent years, China has increased its aid to Cambodia. Specifically, the figures were RMB122 million in 2000, RMB 87 million in

2001, RMB 125 million in 2002, RMB 251 million in 2003, and RMB 252 million in 2004.

Meanwhile, from 1989-2000, China's annual economic aid to Laos accounted for 2 percent of the total aid Laos received from overseas. Two years after Chinese president Jiang Zemin's visit in 2000, Laos received RMB 160 million gratis, RMB 80 million of free-interest loan and RMB 300 million of preferential loans, which is equivalent to the total aid Laos received from China in the past 10 years. Lao's Vang Vieng Cement Factory and National Cultural Centre which set up with Chinese aids received favorable feedback from local residents.

In 2001, during the Secretary of the Communist Party of Vietnam Nong Duc Manh's visit to China, China and Vietnam signed an economic and technical agreement, wherein China would provide RMB 30 million grant aid and US$40.5 million preferential loan to Vietnam. In 2002, during Chinese President Jiang Zemin's visit to Vietnam, another agreement was signed. This time, the agreement indicated that China would extend a RMB 50 million aid and RMB 50 million preferential loan to Vietnam. In 2003, during Nong Duc Manh's return to China, China decided to exempt Vietnam's RMB 420-million debt and to provide an grant aid for the Sino-Vietnam Friendship and Culture Centre. In 2005, during Chinese president Hu Jintao's visit to Vietnam, China provided a RMB 60 million grant aid and RMB 550 million preferential loan to Vietnam.

Table 9: China's Major Aiding Projects to CLMV Since 2003.

Country	Project	Scale
Cambodia	Highway(Kratie-Cambodia-Laos Border)	186km
Laos	Na Teuy-Pak Mun highway	166.5km
Myanmar	International Conference Centre	30000m^2
Cambodia	Government office building	33970m^2

Source: China MOFCOM

China's aid policy and aid programs have the following features:

- The western approach of imposing its values and political system on other countries is not acceptable to China. The principles of friendship, cooperation and development underscore China's pledge not to discriminate or intervene. The outbound aid from developed countries follows the rules made by the Organisation for Economic Cooperation and Development (OECD), which takes into consideration the political condition and economic base of the recipient country. There are some poor countries in desperate need of assistance but fail to get this assistance because of the turbulent situation at home. However, China is not bound by OECD's rules.
- The aiding projects are determined through bilateral consultation, basically civil facilities that can truly benefit the people of the recipient country. China's aid to CLMV has heavily focused on construction of infrastructure. Taking into consideration the larger agricultural sector in these countries, China's aid also emphasizes agricultural technical training. Its ASEAN Agricultural Technical Training programs are extended to these four countries.
- Apart from goods and currency, China also sends medical and rescue teams to these countries.
- China's economic and technical aid to CLMV is not a unilateral donation. Instead, China aims to deepen the friendship and to achieve common growth.

1.3.2 Concerns around China's foreign aid

The cornerstone of China's foreign policy is the respect on the choice of political system and development path suited to other country's own national/specified conditions. This has been reflected in China's foreign aid policy. Two concerns arise regarding China's foreign aid, though. The first is with regards China's aid as a having a mercantilist pattern: that is, the aid helps extract raw materials for its industries and then sell manufactured goods back to these least developed countries while failing to bring sustained growth to the recipient nation's local economy. The second concern is that China's unrestricted lending will undermine years of efforts to arrange conditional debt relief. That is, China does not follow the international lending standards intended to fight corruption in the region.

The fact remains that China's outbound aid shares many common interests with developed countries. Most of China's aiding projects are focused on public health, education, agricultural, and infrastructure. The bottomline of the Chinese government's action is to show solicitude for local people's livelihood, meet the needs of the public and provide what is practical for the people. China also hopes that the recipient countries can improve their public governance and reduce corruption. Whether a recipient country has a clean and honest government or whether this is a democratic government, an efficient infrastructure is a great concern of the recipient's citizens.

Aid programs generally carry a donor country's major policy goals and understanding of national interest. Building a harmonious world has become China's foreign policy. Its government believes that for any impoverished population, the top priority is to ensure its development.

China is the world's largest developing country with a huge population, by the World Bank's criteria. Nearly 200 million Chinese are still living on less than US$1 per day. There are some 60 million disabled people in need of care in China. Despite a generally sound economic development, some deep-rooted problems such as its economic structure, extensive economic growth model, deficient mechanisms, and unbalanced regional development, remain unresolved. Both its economic and social development aspects still encounter difficulties and challenges: e.g., a less-developed foundation, a large gap between urban and rural development and among different regions. Per-capita GDP still ranks 100th in the world. Changing its under-developed productivity will be a long and arduous task. Therefore, the real challenges facing China are its financial constraints as well as expectation from CLMV countries.

2. PROGRESS OF ECONOMIC INTEGRATION

2.1 Early Harvest Plan (EHP) and ASEAN-China FTA

2.1.1 Analysis of trade interest under Early Harvest Plan

The most important policy China made that had significant impact on CLMV since its accession to the World Trade Organization (WTO) may be the signing of the free trade agreement (FTA) with ASEAN. The framework agreement and other subsequent related agreements are now under implementation. In the agreements, China made great concessions to the demand of ASEAN to open the agricultural market, especially in the Early Harvest Plan (EHP). Such made it possible for CLMV to export more products to China.

The EHP under the FTA, a special arrangement based on the requirements of ASEAN, commenced in January 2004. It can be regarded as a prelude to the overall tariff reduction on July 1, 2005. The EHP covered about 600 agricultural products that the ASEAN had most of the advantages. All 600 products in the EHP were divided into three categories:

- Category 1: Most-favored nation (MFN) tariff rates higher than 15 percent for China and ASEAN 6; 30 percent or higher for CLMV.
- Category 2: MFN tariff rates between 5 percent and 15 percent (exclusive) for China and ASEAN 6; between 15 percent (inclusive) and 30 percent (exclusive) for CLMV.
- Category 3: MFN tariff rates lower than 5 percent for China and ASEAN 6; lower than 15 percent for CLMV. China and ASEAN 6 will eliminate the tariff on about 600 tariff lines over three years: to 10 percent before 2004; to 5 percent before 2005; and to zero tariffs not later than January 1, 2006. The CLMV should eliminate their tariff on the products not later than 2010.

Although China enjoys a surplus in its total trade, its trade in agricultural products shows deficits over the years. So, agricultural products are considered among China's products with "comparative disadvantage". China's agricultural deficits are mainly from Indonesia, Malaysia, and Thailand. Therefore, tariff reduction and elimination in agricultural sector needs China's real attention. According to statistics from China's MOFCOM, by September 2007, China's imports of over 600 agricultural products under EHP grew by 500 percent.

In 2003, the average tariff for agricultural products was 16.8 percent for China, 21.9 percent for Vietnam, 20.7 percent for Cambodia, 18.7 percent for Laos, and 8.3 percent for Myanmar. According to the EHP, the MFN tariff rates above 30 percent are scheduled to be reduced to 20 percent by January 2004, and to 5 percent annually until it reaches zero. Meanwhile, the MFN tariff rates of 15-30 percent from Vietnam are scheduled to be reduced to 10 percent by January 2004, 5 percent by January 2006, and zero by January 2008. That of Cambodia, Laos and Myanmar should be 10 percent by 2006 and 5 percent by 2008.

For existing MFN tariff rates below 15 percent, Vietnam's are scheduled to be cut down to 5 percent by January 2004, and to zero by 2006. Similarly, that of the three other countries will be brought down to 5 percent by January 2006 and zero by 2008.

Table 10: Effects of ASEAN 10 by China's Export and Import of EHP Products.

	Increased greatly	**Increased less greatly**	**Not or slightly Affected**	**Decreased**
China's Export (46.49%)	Indonesia (13.14%) Thailand (13.09%) Malaysia (13.05%)	Vietnam (4.05%) Philippines (2.24%) Singapore (1.31%)	Brunei (0.04%) Cambodia (0.04%) Laos (0.02%)	Myanmar (-0.49%)
China's Import (66.74%)	Thailand (54.92%)	Indonesia (8.33%) Vietnam (1.83%) Philippines (1.68%) Malaysia (1.66%)	Brunei (0) Laos (0) Cambodia (-0.03%)	Myanmar (-0.58%) Singapore (-1.08%)

Source: Yuan Bo, CAITEC

Apart from providing a five-year transition period, China initiated a special preferential tariff program to CLM under the EHP. From January 1, 2004, a zero tariff was applied to CLM's 707 products (335 for Cambodia, 239 for Laos and 133 for Myanmar), mainly agricultural products and a few industrial manufactures. Later, China further confirmed that a zero tariff will be applied to 261 CLM products (83 for Cambodia, 91 for Laos and 87 for Myanmar) from January 1, 2006. The bottomline is to improve the bilateral trade position and to import more agricultural products from those less developed neighboring countries, ultimately to support their development. On the other hand, the Chinese government is confident it can control the negative influence or the possible risks arising from the special preferential tariff because China's imports from CLM is fairly small (about US$2.8 billion in 2006) and the major imports from Cambodia and Myanmar is timber while those from Laos, although involving some agricultural products, are of small volume as well. In sum, the impact on China's similar products will be limited.

In the case of China Yunnan Province after the implementation of the preferential tariff policy, imports from Myanmar increased by a small margin, imports from Laos are tending downwards, while no imports came from Cambodia. According to China's Customs department, RMB 18.4 million and RMB 3.2 million worth of tariffs on imports from Myanmar and Laos, respectively, were exempted in 2004.

Table 11: Changes in China's Major Agricultural Imports from Vietnam, 2002-2006.

		% Change			
HS	Description	06/05-	05/04	04/03	03/02
	Vietnam	-2.5	2.9	70.4	30.5
07	Vegetables	138.1	1.2	22.3	114.4
08	Edible Fruit And Nuts	59	80.8	-53.6	-0.1
11	Milling; Malt; Starch	110.9	-7.1	50.1	110.6
03	Fish And Seafood	-24.2	68.5	28.9	0.7
09	Spices, Coffee And Tea	149.1	-4.7	-3.9	65.0

Source: China customs

Table 12: Changes in China's Major Agricultural Imports from Laos, 2002-2006.

HS	Description	06/05	05/04	04/03	03/02
10	Cereals	567.3	292.5	679.0	-75.1
12	Misc Grain, Seed, Fruit	76.6	3.4	-7.1	-5.6
13	Lac;Vegetable Sap, Extrct	366.5	0	0	0
09	Spices, Coffee And Tea	0	-100	-43.8	55.7
06	Live Trees And Plants	-49.3	471.3	0	0
01	Live Animals	0	0	0	-100
02	Meat	0	0	0	-100
04	Dairy, Eggs, Honey, Etc	0	0	0	0
07	Vegetables	0	0	0	0
08	Edible Fruit And Nuts	0	-100	0	-100

Source: China customs

- The CLMV will possibly become a main source of China's grain imports. The CLMV has a stronger comparative advantage in land-intensive agricultural products. According to the forecast made by China State Development Research Center, China's net imports of grain will reach 9.76 million ton in 2010 and 22.24 million ton in 2020. Vietnam is the world's major rice exporter; and Myanmar, Laos and Cambodia all have favorable conditions for agricultural development. The potential, therefore, is promising.
- Technical cooperation in the field of agriculture should be strengthened. Mechanization of agriculture in CLMV is still low, whereas China has a certain advantage in agricultural machinery, fertilizer, pesticide, seeds, packing, and preserving skills, which can help CLMV to improve their agriculture output and market share.
- The preferential tariff treatment can only be effective when the recipient country has the appropriate trading ability.

2.1.2 Assist CLMV to effectively participate in and benefit from the ASEAN-China FTA

The ASEAN-China substantive cooperation was further enhanced in 2001 when the leaders of ASEAN and China endorsed a proposed framework on economic cooperation and an FTA for 10 years as well as identified five priority areas to move cooperation. This was in the areas of agriculture, information technology, human resource development, mutual investments, and Mekong cooperation.

The framework agreement designed the timetable of tariff reduction or elimination. This time, the measures "for promotion and facilitation of trade in goods and services, and investment" are listed as (1) standards and conformity assessment; (2) technical barriers to trade/nontariff measures; and (3) customs cooperation. Other measures mentioned in the framework agreement are: "increasing the competitiveness of SMEs; promotion of electronic commerce; capacity building; and technology transfer." (Framework Agreement, Article 7.3)

According to the feasibility study report of 2001, the ASEAN-China Free Trade Area (ACFTA) can increase ASEAN's export to China by 48 percent and China's exports to ASEAN by 55.1 percent. The ACFTA can increase ASEAN's GDP by 0.9 percent (US$5.4 billion) while China's real GDP can expand by 0.3 percent (US$2.2 billion).

The ASEAN-China FTA is a regional agreement. It includes more contexts than pure "trade". In fact, the mechanism will be conducive to improving the geo-political climate, cracking down cross-border crime, protecting the environment, and stopping drug smuggling. The cooperation will be also conducive for the two sides to gain more support in international affairs and regional security.

All cooperation must recognize the different stages of economic development among member states and the need for flexibility. In particular, it must recognize the need to facilitate the increasing participation of CLMV in the ASEAN-China economic cooperation and the expansion of their exports by strengthening their domestic capacity, efficiency, and competitiveness. Otherwise, fully economic liberalization means that these less developed economies close all their enterprises.

China is a strategic friend for CLMV. The latter looks to China for development support and cooperation, as it does its fellow members in ASEAN. The CLMV is seeking to find a place in the ASEAN-China FTA, both on their own and as members of ASEAN.

To assure the success of the ASEAN-China FTA in the future, one needs to stress the following:

- Adopt more effective measures to support the economic development in CLMV and to break through the bottlenecks that limit the bilateral economic plans.
- Strengthen mutual trust and regional recognition among the people. Such trust and recognition will push the government to make concessions.
- Aim for "bridging the gap" as a long-term priority in ACFTA's strategy. Desired projects should focus on the urgent needs of CLMV to improve their national environment, and should be conducted in a coordinated and effective manner so as to achieve and sustain long-term positive impacts on economic growth.
- Make sure that adequate funding for the desired projects is guaranteed.

2.2 Greater Mekong Subregion (GMS) cooperation

2.2.1 Progress and future plan

The GMS program, proposed by the Asian Development Bank in 1992---much earlier than the proposal of ACFTA---is a very important part in the cooperation among China, Thailand and all CLMV countries that received China's official assistance over the years.

The GMS is an important corridor linking China with Southeast Asia and South Asia. The CLMV's share in the total area of the Mekong basin is 66 percent, while China Yunnan accounts for 16 percent. The development of GMS depends mostly on the relationship between China and CLMV countries. Soon after the signing of Agreement on Commercial Navigation on the Lancang (Mekong) River in 1999 with Thailand and the CLMV, China invested US$5 million to dredge the upper Mekong River.

In March 2004, China exchanged letters with Laos and Myanmar, agreeing to provide aid to their power projects and to grant nearly US$300 million for the highway project within Laos. China and Vietnam also agreed to set up closer working ties.

China decided to explore ways to participate in the development of hydroelectric resources in Laos, Myanmar, and Cambodia, and cooperate with Vietnam in the feasibility research on the joint development of Vietnam's coal and natural gas. China will actively exchange information with the relevant countries on economic development and power systems, and help establish an information exchange platform on power cooperation.

The GMS program is a choice of CLMV to build closer relations with China. On the other hand, it is also a strategic choice made by the Chinese government to create an opening for China's mid-western areas. The program will integrate the trade, tourism, transport, power, and information of China's western area with CLMV, and possibly shape a regional economic, financing, and logistic center. It will also attract the attention and participation of China's coastal areas, which in turn will provide the western area an opportunity to upgrade its industries.

China is both a beneficiary and a contributor to the GMS program. It provided the funds for the Kun-Bang Super Highway and local channel improvement in the upper Mekong River. It conducted 500 person-time training for member-countries in the field of agriculture, customs, and telecommunication. In 2004, China established a US$20 million special fund in ADB meant for human resource development and poverty relief in Asian developing countries (in particular, the CLMV countries).

China has made the fastest progress in the area of trade and investment facilitation, setting an example to member-countries. It created a core group handling trade and investment activities. This group holds meetings every semester to review the implementation of the framework action plan. Based on the reviews, China has made its own action plan and implementation mechanism so as to ensure a stable and smooth progress. This program warmed up China's relations with CLMV, speeded up bilateral economic cooperation, and helped China to regain its influence in the Indo-China region.

In July 2005, China published *the Country Report on China's Participation in*

GMS Cooperation, which defines her new plans for the GSM program, to wit:

1) Decide the east-line plan for the Trans-Asian Railway;
2) Improve the technical reliability of power trading by shifting power cooperation from "End to Lan" to "Lan to Lan";
3) Speed up the construction for the information superhighway;
4) Start cross-border prevention and control of animal disease;
5) Promote cooperation among GMS countries in environmental protection;
6) Further increase the inputs for training of human resources and lead the establishment of "the Golden Triangle Tourist zone" and "Tengchong-Myitkyina Tourist Zone";
7) Provide modern facilities in Kunming and other port cities for commodity fair and trade talks; and
8) Push for a more stable cooperative mechanism at central government level on drug abuse and illicit trafficking.

2.2.2 Major contradictions in the cooperation process

Contradiction between upstream and downstream countries. An upstream country is in an advantageous position since the downstream countries have to passively accept the negative effects arising from development of water resources. If there is no agreement on joint management of water resources, disputes between upstream and downstream countries are inevitable. China's large-scale dam construction gave rise to great concerns from downstream countries, who believe this will affect their eco-environment and livelihood and pose a threat to people's lives in terms of flood and earthquake. However, Chinese scientists gave their own explanation, arguing that the bigger factor affecting the water level is the change in macro environment such as the climate and land utilization. In all these, China has taken relevant measures to protect the eco-environment of downstream regions. For instance, the hydropower station in Lancang River can control and adjust the water flows, which will ensure the safety of the downstream countries' production, livelihood and property.

Contradiction between government and NGO. Joint actions taken by inward and outward nongovernmental organizations (NGOs) exert pressures on governments and international organizations that support the Mekong river development, such as the ADB and WB.

On the whole, infrastructure will still be the major focus in China's future cooperation in GMS, since railway and inland waterway development lag much behind highway development. China will play an important role in the GMS cooperation since it has the strongest in comprehensive economic plan and highest economic growth among the GMS member-countries. From a long-term perspective, China should establish its leading position in subregional cooperation.

2.3 China's action

2.3.1 Policy and administration on border trade

In 1992, to push forward the barter trade (including border trade) with the former Soviet Union and Eastern European countries, a package of policies were implemented, which shifted China's border trade into higher gear. However, the problems associated with disordered markets and low-grade export products emerged simultaneously, which led the government to rectify the order of border trading in 1994.

Land-growing products such as grain, vegetables and fruits, and textiles and garments, and light industrial products are the mainstay of China's border trade exports to LMV, while the major imports are raw material products, which included timber, steel, paper pulp, minerals, and nonferrous metals.

China's border trade system is a combination of centralized and decentralized administration. Local governments play a significant role in border trade administration, but as part of China's foreign trade, a unified administration is also imposed. In this regard, the Ministry of Commerce and related departments of the State Council are jointly held responsible for formulating policies and exercising macro administration on border trade.

Border trade has now become a dominant force behind the economic growth of China's border areas and plays a substantial role in achieving China's goal of "vitalizing border areas, building a well-off society, benefiting the nation and bringing stability to the country." Currently, there exist two forms of border trade in China:

(1) Goods exchanged by border residents

Exchange of goods between border residents refers to the trade activity involving goods that are below the government-designated market's amount or quantity within 20 kilometers from the boundary line. The government imposes a ceiling on the value of goods exchanged by border residents. This form of border trading caters to the economic and daily conveniences of the people living on both sides, so that each makes up one's deficiency with the other's surplus.

(2) Border trade in small amounts

Border trade in small amounts refers to the trade activity between the enterprises or trading organizations along the borders of neighboring countries, and Chinese enterprises that are granted operational rights to trade in small amounts in the administrative areas of open border counties (banners) or towns along the boundary line. Trade activities other than exchanging goods shall be brought into the common administrator on border trade and subjected to its related policies.

In the early 1990s, the guiding ideology on border trade was "for each to make up the other's deficiency with one's own surplus". Its theoretical basis is the international division of labor in world trade and the principle of geo-economics, which calls for achieving complementary economic advantage for border regions, and enhancing regional economic cooperation and interchange.

The principal legal basis for China's border trade policies is the Law on the Regional Autonomy for Ethnic Minorities of PRC, Foreign Trade Law of PRC. Article

42 of the Foreign Trade Law of PRC stipulates that "the State applies flexible measures, provides favorable conditions and convenience to the trade between the towns on the frontier and those towns of neighboring countries on frontier as well as trade among border residents."

According to the *Circular of the State Council on Issues Covering Border Trade* promulgated in 1996, goods (those for daily consumption only) imported as exchanged goods by border residents and valued at less than RMB 1,000 (later revised to RMB 3,000) per person per day shall be exempt from import tariffs and import linkage value-added tax. In case the amount exceeds RMB 1,000, the excess amount shall be taxed accordingly.

The registered capital of enterprises engaged in border trade of products in small quantities should not be less than RMB 500,000, and proof of a fixed business site, facilities, and funds are required. Furthermore, the enterprises should have a sound organizational system and personnel qualified to carry out the border trading activities.

Except for commodities that call for tender and chemicals for both military and civil use and as components of drugs, the quota and license system on exports up to the set quantity shall be eliminated. Enterprises engaged in border exports shall enjoy the export tax refunding policies that applied to ordinary trade, and go through the same refunding process.

On the other hand, the import of commodities is subjected to state quota and licensing system, or quantitative restrictions. The foreign trade and economic administrative departments of border provinces and regions shall be responsible for issuing import license.

2.3.2 China's border trade with CLMV

China's border trade with LMV is characterized by small-scale, limited varieties, and flexible trading arrangements. The Renminbi is used in settling trade accounts.

Table 13: Time of Border Trade Resumption.

Yunnan Province	1985	Myanmar, Laos
	1992	Vietnam
Guangxi Zhuang Autonomous Region	1992	Vietnam

Source: China MOFCOM

Table 14: Socioeconomic Development of Yunnan and Guangxi.

	Unit	2000	2006
Population			
Yunnan	Million person	42.4	44.8
Guangxi	Million person	47.5	46.9
GDP			
Yunnan	CNY Billion	201.1	400.2
Guangxi	CNY Billion	205.0	480.2
Annual GDP Growth Rate			
Yunnan	%	7.5	11.9
Guangxi	%	7.3	13.5
Growth Rate of Import and Export Value			
Yunnan	%	9.2	31.4
Guangxi	%	16.2	28.8
GDP per Capita			
Yunnan	Yuan/person	4742	8961
Guangxi	Yuang/person	4319	10240

Source: Commerce Yearbook of Yunnan and Guangxi, 2007

Table15: Imports and Exports of Border Trade in Yunnan Province (RMB 10,000).

Year	Exports	Imports
1990	72148	35726
1995	96882	93153
2000	230180	64738
2001	190454	95881
2002	191642	115790
2003	209574	137870
2004	257197	179353
2005	321188	224143

Source: Kunming Customs

Table 16: China's Border Trade with Myanmar (US$100m).

FY	Total trade	Border trade	Share %
04/05	7.8055	3.5499	45.5%
05/06	8.3309	5.1744	62.1%
06/07(ending in Feb)	10.3168	8.1505	79.0%

Source: Ministry of Commerce, Myanmar.

2.3.3 Some noteworthy problems restricting the development of border trade

After over 10 years, border trade in "small" quantities no longer remains small and encompasses areas beyond the border's scope, tending in fact toward transit trade. There are, however, some noteworthy problems that restrict the development of border trade:

- In border trade, many import and export commodities still have quantitative quotas, and mobility of business people is still subjected to various formalities.
- China's policy adjustment on its imports and exports poses a new challenge to border trade growth. The reduction in export rebate tax somewhat cripples the competitiveness of export commodities. Approval rights for import, inspection and quarantine were taken back by the State General Administration. Customs, forestry and technical quality supervisory entities had all tightened their control over border trade. State limits on export of grain also tend to tighten. Border personnel under the Ministry of Public Security are strict in their control over exit and entry.
- Trade logistics in border areas are still underdeveloped. In recent years, infrastructure of trading ports in these areas have improved, but because of limited funds, these have fallen far behind the growth in port logistics, particularly storage, freight yard, and parking sites. Currently, these ports can only satisfy the basic customs requirements.
- Highways across borders are not in good condition.

3. CHINA'S DEVELOPMENT STRATEGY WITH CLMV

3.1 Policy of friendship and partnership with neighboring countries

3.1.1 China's peaceful development

Chinese leaders have on various occasions aired their view of building "a coordinated world" and sticking to peaceful development. The way toward a coordinated world involves seeking for a common security through multilateralism, aiming for development and common prosperity through mutually beneficial cooperation, and working toward harmonious relations through mutual understanding.

After over 30 years since it opened its economy and initiated reforms, China has accumulated certain political influence, diplomatic skills and economic strength. Gaining a good impression and goodwill from the international community is the key to China's diplomatic affairs.

Peaceful development now has been adopted as a formal government strategy, a clear blueprint to guide China's future development in the next 20 years. Achieving development is the overriding principle.

Peaceful development is also China's contribution to the current international system. This concept is China's answer to the "China Threat" debate and the efforts of other countries to define China's evolving role in world affairs.

China's influence in international economic affairs is increasing. As one of the world's largest countries, China is ready to shoulder more responsibilities, pay greater attention to underdeveloped regions and people in poverty, and play an active role in promoting development, progress and harmony.

China has sent a clear message to the world that it will achieve its development mainly through its own efforts, which will help assuage the international community's notion that China is bound to engage in external plundering and expansion when it reaches a certain stage of its development. As China develops itself, it will contribution more to both the development of neighborhood areas and the whole world.

China does not use ideology or social system as a criterion in conducting diplomacy and economic cooperation, nor does it impose its values on others. This means that China will treat all countries, whether big or small, rich or poor, as equals. It also means that China will follow the principle of mutual benefit and mutual respect in expanding overseas business ties.

As China's overall national strength and international standing grow, the international community will have higher expectation from it. In the future, China will take an active part in the formulation of international rules for a fair and equitable international economic order, and in international and regional economic cooperation.

3.1.2 A favorable neighborhood is crucial to China's peaceful development

China's development involves striding toward the subcenter and center position of the global system. In the course of doing so, China needs the understanding and support of developing countries, particularly neighboring countries. The China-CLMV relations have come a long way from the initial removal of doubts to commencement of dialogue, to enhancement of mutual trust, and to establishment of strategic partnership.

In the political field, mutual trust is growing. China was the first ASEAN dialogue partner to join the Treaty of Amity and Cooperation in Southeast Asia and to establish strategic partnership for peace and prosperity with ASEAN. The two sides jointly issued the Declaration on the Conduct of Parties in the South China Sea.

The policy of "pursuing good neighborly relations and partnership with neighbors" and "fostering a harmonious, secure and prosperous neighborly environment" was first put forward during the 16th National Congress of the Communist Party of China since the party realized that China's development needs a peaceful international environment. China is also aware that in the past there was a good deal of suspicion over its intention.

A harmonious neighborhood means to live in harmony with neighboring countries. A secure neighborhood, meanwhile, means to solve differences through negotiation and improve mutual trust. A prosperous neighborhood does not simply mean one who gives money to neighbors. Rather, it means a better use of resources from both sides and an ability to cooperate in adjusting each side's economic structure so as to cope with the challenges posed by economic globalization.

China's good-neighbor policy during the initial founding of the new China was determined by the pattern of world political affairs. The starting point was its own security. In the 1950s, its security threat was mainly from the United States. Now, the starting point of China's good-neighbor policy since its reform is its development. Only by winning over neighboring countries' trust can China break the anti-China ring and create a better international environment for its domestic development.

China's good-neighbor relation, to some extent, is a kind of investment. It will ultimately improve the nation's outward investment climate. China's participation in the GMS cooperation is a good example: China contributed to the development of the subregion, while at the same time, became a beneficiary of the subregion's cooperation. China's riparian areas and sectors have all benefited from such cooperation.

China's relations with her neighbors will give it more room for action in international affairs. More trading and cooperative partners mean China will not be controlled easily by world giants. Its success as a good neighbor will also benefit its image to the world. Now, the real Chinese "threat" is economic, not military strength. The world no longer worries about how China will feed itself but whether Chinese products will hit domestic markets.

China's relations with CLMV now have two features: close high-level contacts, and brisk economic cooperation. The Chinese government thinks that as a good partner, neighbor and friend of CLMV, it is obliged to lend a hand. China has experience in helping small and developing countries. Its government knows exactly what these countries need and can provide them with very practical skills and technology.

China is convinced that a united, stable, and prosperous neighborhood will make greater contribution to the world as well as to its own development. On the 15th anniversary of the China-ASEAN dialogue relations, China announced it will donate

US$1 million to the ASEAN Development Fund and provide funding assistance worth US$1 million to relevant projects under the Initiative for ASEAN Integration. China also offered to train 8,000 ASEAN professionals in different fields in the next five years and invited 1,000 young people from ASEAN countries to visit China.

3.1.3 Outside factors affecting China's long-term economic and trade relations with CLMV

Peaceful development environment in CLMV. The CLMV's economic development lags behind in the region. A large percentage still lives in poverty, which is coupled always with some form of turbulence. A peaceful development environment will depend on whether the current governments can commit themselves to improving their people's livelihood and safeguarding the rights of different ethnic groups. After all, any insurgency can threaten border security and any proposed economic cooperation.

ASEAN's diplomatic strategy. The ASEAN's current strategy is to stand between China, the United States and Japan, so as to balance their influences in the region. The ASEAN does not want to fully depend on China, and is unwilling to be forced to make a choice between big powers.

The ASEAN's views on the China issue are divergent. Some raise doubts about whether China's investment conforms to ASEAN's long-term interests. Some worry that China might challenge ASEAN's value system, and overdependence on China would isolate the ASEAN and cut itself off from help if China one day changes its policy. Although the ASEAN clearly defines the strategic partnership with China, its policy on China remains unclear. In the coming 15 years, China's position and influence on ASEAN's strategy, and the trend of China-ASEAN strategic partnership are issues that still need to be discussed.

US factor. In the post-cold war era, the United States changed its role in Southeast Asia from peace keeper to coordinator. Today, the United States is still playing an important economic role in Southeast Asia. At the same time, it retains its military presence in the ASEAN countries.

China and the United States have different attitudes toward the military government of Myanmar. The United States appeals for more pressures on Myanmar's human rights record and urges Myanmar to release all political prisoners and move toward democracy, and stop forced labor. It thinks economic sanctions are necessary to punish Myanmar's government and force the issue of democratic change. The US trade sanction and embargo against Myanmar still stands. The US believes that China's influence on Myanmar is second to none and could be decisive in restraining the government from a violent confrontation with protesters.

Japan factor. The Indo-China Peninsula---where Laos, Cambodia, and Vietnam are located---produces a great impact on Japan and is regarded as Japan's sea lane. If Japan wants to reinforce its major role in Asia, it has to establish contact with these countries. The United States-Japan Joint Declaration on Security has extended its application to the South China Sea. Japan is involved in the Indo-China Peninsula mainly by two means: its Official Development Assistance and its leadership position in the Asia Development Bank (ADB).

Contest for South China Sea. The territorial dispute in the South China Sea has been an obstacle to the development of China-CLMV relations. China claims sovereignty over the Nansha Island and its surrounding waters, but is open to shelve disputes and carry out a joint development. The ASEAN worries that China's proposal of "shelving sovereignty" only means to put off the negotiations and wait until it grows strong enough to settle through military might. This is a hidden problem that can break out any time. It is unreasonable to think that the South China Sea issue will not lead to a strained relation with surrounding nations. Therefore, how to avoid conflicts as well as to promote trust, understanding, and cooperation is still a challenge.

4. POLICY IMPLICATIONS

- There is a need to conduct more trade and investment promotion activities, so as to provide a platform for special products from these countries and an opportunity for Chinese counterparts to know more about the investment climate and policies in these countries.
- There is a certain difference among CLMV countries; therefore, a detailed assistance plan should be made for each country. China should continue to develop infrastructure that is in great demand in CLMV countries and provide assistance to improve bilateral trade positions.
- To reinforce the trade in border regions, give priority to the export processing industry and tourism, free administration on exit-entry, money flow, goods transaction, integration in bonded areas, warehousing, exhibition, packaging, processing, and tourism. Policies adopted in border regions should be more preferential than that of the ASEAN-China FTA and Early Harvest Plan.
- Weaken the industrial competition between China and CLMV and set up a development fund. The starting point is to provide more job opportunities in CLMV countries. China should pay attention to the political and social problems arising from the competition between China and CLMV, since market chances provided by China will first benefit the big companies, not the public, particularly the poor.
- In spite of material aid, China should help CLMV in systematic improvement.
- The GMS cooperation has brought a general concern: More and more international organizations are getting involved in this cooperation, which leads to a co-existence of multi-mechanisms, but lacks both supervising and dispute settlement mechanisms.

- To avoid repetition in scheme and projects, there should be a clear, coordinated and common target for assisting CLMV among China, Japan, and Korea.
- Consistent and regular studies on the impact of regional economic integration on CLMV should be jointly carried out so as to ensure their initiative and adopt effective policy measures, ultimately to help them coordinate with the global economic system.
- China and CLMV should jointly draw up a development plan for bilateral industrial cooperation, through which to guide and promote industrial integration and upgrading, shape up industrial gradient shift system, and better solve the problem regarding similarity in industrial structures among the nations as well as competition.

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Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China.

Chapter 7

JAPAN'S POLICY AND STRATEGY OF ECONOMIC COOPERATION IN CLMV

Katsumi Uchida and Toshihiro Kudo

ABSTRACT

Japan has undertaken three major initiatives for developing Cambodia, Lao People's Democratic Republic or Lao PDR, Myanmar, and Vietnam (CLMV) since the 1990s: These initiatives were the Forum for Comprehensive Development of Indochina (FCDI) in 1995, the AEM-METI Economic and Industrial Cooperation Committee (AMEICC) established in 1998, and the New Concept of Mekong Region Development announced at the Japan-ASEAN Special Summit in December 2003. The New Concept of Mekong Region Development is a new attempt based on regionwide development. It was included in Japan's Official Development Assistance (ODA) Charter revised in 2003. While Japan is a top donor to CLMV and Thailand, its regionwide development vision and strategy for these areas are not clear. In order to implement regionwide development efficiently and effectively, it is essential to pursue studies related to regional public goods provided by regionwide development. Despite the huge ODA provisions to CLMV, Japan's trade and investment relations with these countries are still weak compared to its relations with the original six member-countries of the Association of Southeast Asian Nations (ASEAN). Another challenge for Japan is how to promote trade and investment with CLMV.

1. INTRODUCTION

During the Cold War era, Japan extended ODA loans for the Prek Tnaot Multi-Purpose Dam Construction Project in Cambodia in 1969, the Can Tho Thermal Power Plant Construction Project in South Vietnam in 1972, and the Hydroelectric Power Project at the Namgum Dam in Laos in 1974 and 1976. After that, however, Japanese assistance to these three countries was mostly suspended because of the various armed conflicts during the Cold War.

In contrast, Thailand received a huge amount of aid from the Western countries as an ally of the western block. The provision of Japanese ODA loans to Thailand began in 1967 with the cumulative ODA to Thailand amounting to ¥1,066,142 as of the end of March 1990 (Table 1). From the early years of the assistance, the emphasis was placed on developing infrastructure, especially roads, electricity for rural areas, and irrigation facilities. The main development objective was to narrow the gap between urban and rural areas. Thailand effectively used Japanese ODA loans for the improvement of economic infrastructure. As a result, its economy continuously developed and the influx of foreign direct investment (FDI) accelerated beginning the second half of the 1980s. With the economic development of Thailand, grant-based assistance to this country ended in 1993, in principle.

Myanmar was the second largest recipient country of the Japan's ODA in the Indochina region. Myanmar ranked among the top five as one of the largest recipients of Japan's ODA in 1985 and 1986. As of the end of March 1988, the cumulative total of ODA loan commitments to Myanmar since 1969 amounted to ¥402.972 million under 66 commitments. However, Myanmar's economy declined due to the closed-door policy of Burmese-style socialism. As a result of the economic collapse, Ne Win's socialist government ended in July 1988, and a military government was formed under much political and economic confusion. Japan stopped extending ODA loans to Myanmar in 1988.

Table 1: Japan's ODA to the Indochina region during the Cold War

	Cambodia	Laos	Myanmar	Vietnam	Thailand
Yen loan	1,517	5,190	402,972	40,430	833,011
Grant aid	2,637	23,214	97,594	31,292	141,324
Technical	1,706	4,613	15,097	2,449	91,807
Total	5,860	33,017	515,663	74,171	1,066,142

Source: Ministry of Foreign Affairs (MOFA) of Japan.

In 1986, Vietnam and Laos introduced market economy policies known as Doi Moi (Renovation) and Chin Tanakan Mai (New Thinking), respectively. On the other hand, Cambodia signed the Paris Peace Agreement in 1991. With the end of the Cold War and the political stabilization of the Indochina region, the Economic Cooperation in the Greater Mekong Subregion (GMS) Program was created by the six countries sharing the Mekong River; namely, Cambodia, Laos, Myanmar, Thailand, Vietnam, and the Yunnan Province of the People's Republic of China. This was done with the help of the Asian Development Bank (ADB). The first GMS Ministerial Conference was held in November 1992. The aim of the GMS Program is to accelerate economic integration by stimulating the movement of people, goods, and capital, and to contribute to poverty reduction by developing infrastructure and promoting industrial competitiveness. ADB became the secretariat of, and the main coordinating body running, the GMS.

In this paper, the authors first examine Japan's economic cooperation policy and strategy for the development of CLMV, and then examine its trade and investment relations with CLMV.

2. JAPAN'S INITIATIVE FOR THE DEVELOPMENT OF CLMV COUNTRIES

Table 2 shows Japan's major initiatives for the development CLMV countries since the 1990s. There are three major initiatives: the Forum for Comprehensive Development of Indochina (FCDI) held in 1995; the AEM-METI Economic and Industrial Cooperation Committee (AMEICC) established in 1998; and the New Concept of the Mekong Region Development announced at the Japan-ASEAN Special Summit in 2003.

2.1 Forum for the Comprehensive Development of Indochina (FCDI) and the collaboration with ADB-GMS Program

In January 1993 during his tour of the ASEAN nations, Japanese Prime Minister Kiichi Miyazawa proposed the Forum for the Comprehensive Development of Indochina (FCDI) as a venue for a debate and exchange of views on the balanced development of Indochina.. The Ministerial Meeting of FCDI was held in Tokyo in February 1995. Chaired by Japan, 25 nations, including Vietnam, Cambodia, Laos, the six ASEAN member countries, and eight international organizations, such as the European Committee (EC), assembled at the meeting.

Table 2 Japan's major initiative to the development CLMV countries since 1993

	Japan's Initiative	International organizations and ASEAN's Initiative
1992		Economic Cooperation in the Greater Mekong Sub-Region (GMS) Program was created by ADB
1993	Forum for Comprehensive Development of Indochina was proposed by Japan	
1994	Working Group on Industrial Cooperation for CLM was formed between Japan and ASEAN and Indochina nations	
1995	Japan hosted the Ministerial Meeting of the Forum for Comprehensive Development of Indochina in Tokyo (Feb.)	Mekong River Commission was reinogurated (April) Vietnam joined in ASEAN (July)
1996	Task Force for Strategies for Development of the Great Mekong Area was formed by private sector specialists	Ministerial Meeting on ASEAN-Mekong Basin Development Cooperation (AMBDC) was formed by ASEAN
1997	Japan-ASEAN South-South Cooperation Program started Japan-ASEAN Program for Comprehensive Human Resources Development	Mekong Project Development Facility (MPDF) was created by IFC (March) Laos and Myanmar jjoined in ASEAN (July)
1998	Japan-ASEAN Solidarity Fund (JASF) was estblished AEM-METI Economic and Industrial Cooperation Committee (AMEICC) was established	
1999	Japan suponcered UNESCAP's Symposium on the Comprehensive Development of the Greater Mekong Subregion	Cambodia joined in ASEAN (April)
2000	Japan-ASEAN General Exchange Fund（JAGEF）was estblished (July) AMEICC's West East Development Corridor WG was formed (Oct.)	GMS-Business Forum (GMS-BF) was established by the ADB and UNESCAP Initiative for ASEAN Integration (IAI) launched (Nov.)
2001	Japan - ADB joint mission was dispatched to Mekong Basin countries (July)	Ha Noi Declaration on Narrowing Development Gap for closer ASEAN Integration was adopted by ASEAN(July) ASEAN integration System of Preferences (AISP) Scheem endorsed (Sep.) 10th GMS Ministerial Conference anounced GMS 10-year Strategy (Nov.)
2002	JICA-ASEAN Regional Cooperation Meeting (JARCOM) was established	IAI Work Plan for Narrowing the Development Gap within ASEAN (july 2002-June 2008) was approved by ASEAN (Nov.)
2003	Revised Japan's Official Development Assistance Charter was published (Aug.) Japan commted to fund six IAI Infrastructure projects to CLMV (US$ 0.5 mil.) through JAGEF (Oct.) Japan announced New Concept of Mekong Region Development with US$ 1.5 billions economic cooperation over the coming 3 years (Dec.)	Ayeyawady-Chao Phraya-Mekong Economic Cooperation Strategy (ACMECS) was established under Thailand's Initiative (April)
2004		Intergovernmental Agreement concerning the Asian Highway Network was signed by 26 countries At the ESCAP conference (April) CLV Development Triangle was announed (Nov.) Regional Cooperation Strategy and Program (RCSP)(2004-2008) was announced by GMS with Development Matrix (Dec.)
2005	Japan sent a study mission to the CLV Development Triangle (Mar.)	
2006	Japan-ASEAN Integration Fund (JAIF) was established (Mar.)	
2007	Japan granted US$ 52 million to JAIF. US$ 41 million was allocated for assistance to the development of the Mekong region (CLMV) as well as Japan's new initiative to expand its ODA to the Mekong region for the next three years (Jan.)	

(Source) MOFA of Japan etc.

The objectives were the: (1) development of the whole of Indochina from a regional perspective; (2) international cooperation through voluntary coordination of assistance based on information exchange among the participating nations and organizations; and (3) promotion of market economies in the three countries.

At the meeting, an agreement was reached on the establishment of working groups on infrastructure development and human resources development for the two priority areas and the establishment of an advisory group on trade and investment. Japan was chosen to chair the infrastructure development group with the collaboration of the ADB while France chaired the human resources group with the collaboration of the United Nations Development Plan (UNDP). Furthermore, Thailand was chosen to chair the private-sector advisory group with the collaboration of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP).

As follow-up to FCDI, a private-sector advisory group on trade and investment convened in Bangkok in March 1996, a working group on infrastructure development in Sydney in September 1996, and a working group on human resources development in Bangkok in December 1996. Since then, however, the Ministerial Meeting of FCDI has never reconvened.

It seems that Japan failed to take initiative for the Indochina region's development through FCDI. However, one of the main objectives of FCDI is coordination among donors, and Japan has been particularly active in providing assistance to projects related to the East-West Economic Corridor (EWEC) in accordance with the GMS framework of ADB[1]. Japanese ODA loan projects include the construction of the Second Thai-Laos Mekong Bridge, Route 9, and Highway 1 leading to Da Nang Deep-Sea Port. In

[1] The GMS framework became important for Japan because the ASEAN adopted the framework as a master plan for the Mekong Region Development in 1996.

Table 3: Japan Special Fund for the ADB-GMS Program, 1993-2000

(in thousand US$)

1993	Promoting Subregional Cooperation among Cambodia , the People's Republic of China, Lao People's Democratic Republic, Myanmar, Thailand and Viet Nam (Phase 2)	2,500
1995	The Subregional EnvironmentalMonitoring and Information System Project	1,000
1995	Greater Mekong Subregion – Infrastructure Improvement: Ho Chi Minh City to Phnom Penh Highway	3,000
1996	The Cooperation in Employment Promotion and Training in the Greater Mekong Subregion Project	600
1996	Subregional Environmental Training and Institutional Strengthening in the Greater Mekong Subregion	800
1996	The Mitigation ofNonphysical Barriers to Cross-border Movement of Goods and People	180
1996	Promoting Subregional Cooperation among Cambodia, the People's Republic of China, Lao People's Democratic Republic,Myanmar, Thailand and Viet Nam (Phase 3)	3,000
1996	East-West Transport Corridor Project	3,000
1997	The Chiang Rai-Kunming Road Improvement via Lao PDR Project	600
1997	The Mekong/Lancang River Tourism Planning Study	600
1997	The Cross-Border Movement of Goods and People in the Greater Mekong Subregion	550
1997	The Poverty Reduction and Environmental Management in Remote GMS Watersheds	1,000
1998	The Strategic Environmental Framework for the Greater Mekong Subregion	600
1998	The Study of the Health and Education Needs of Ethnic Minorities in the Greater Mekong Subregion	300
1998	Tourism Skills Development in the Greater Mekong	1,250
1998	The Protection and Management of Critical Wetlands in the Lower Mekong Basin	1,000
1999	Facilitating the Cross-Border Movement of Goods and People in the Greater Mekong Subregion	950
1999	Preventing HIV/AIDS among Mobile Populations in the Greater Mekong Subregion	450
1999	Greater Mekong Subregion Promoting Subregional Cooperation among Cambodia, People's Republic of China, Lao People's Democratic, Myanmar, Thailand and Viet Nam (Phase 4)	800
1999	The Greater Mekong Subregion Preinvestment Study for the East-West Economic Corridor	350
1999	Preparing the Mekong/Lancang River Tourism Infrastructure Development Project	600
1999	The Subregional Environmental Monitoring and Information Systems (Phase 2)	100
2000	The Roll Back Malaria Initiative in the Greater Mekong Subregion	600
2000	Promoting Subregional Cooperation in the GMS (Phase 4, Year 2)	800
		24,630

Source: MOFA of Japan.

addition, ADB's Japan Special Fund (JSF) has been used for the GMS program (Table 3).

The Japanese Government dispatched to the CLMV countries a joint mission with the ADB in July 2001 to reaffirm the situation and needs of each country. Based on the outcome of this mission, Japan announced that it will cooperate in the establishment of the EWEC and the development of the Second East-West Corridor (Bangkok-Phnom Penh-Ho Chi Minh Road), which has also been identified as a principal route in the

Asian Highway network.

2.2 Establishment of the AEM-METI Economic and Industrial Cooperation Committee (AMEICC) and Japan's cooperation with the Initiative for ASEAN Integration (IAI)

The ASEAN was established by five countries in Southeast Asia in 1967. Brunei, which became independent from the United Kingdom, joined the ASEAN in 1984. Vietnam became a member in 1995; Laos and Myanmar, in 1997; and Cambodia, in 1999. It became essential for the ASEAN integration to narrow regional disparities between the newly joined CLMV countries and the developed ASEAN countries.

One of main areas of cooperation between Japan and the ASEAN has been the AEM-METI Economic and Industrial Cooperation Committee (AMEICC), which was established under Japan's initiative in 1998. AMEICC set up the working groups for eight subsectors during the third meeting held in Chiang Mai in October 2000. Then the working group on the West-East Corridor Development (WEC-WG) put forward the West-East Corridor Comprehensive Industrial Development Program, with the aim of establishing an industrial and distribution network in the West-East Corridor region from 2004 to 2006. Its activities include entrepreneur support training programs focusing on promising industries; programs to improve the processing technologies of companies in rural communities; and training to facilitate trade with CLMV countries with special focus on improving international business capabilities. WEC-WG presented the "Study for Special Economic Zone Development in CLMV Countries" at the third CLMV-Japan Economic Ministers Consultation held in Manila in August 2007.

On the other hand, the ASEAN itself moved to formulate a framework of the ASEAN Mekong Basin Development Cooperation (AMBDC) program in 1996. It focused on traffic/transportation (including the construction of a railway linking Singapore and Kunming in China), trade, and human resources development. Furthermore, in November 2000, the Initiative for ASEAN Integration (IAI) was agreed upon at the fourth unofficial ASEAN Summit in order to reduce gaps between old and new ASEAN members and to improve regional competitiveness. Two years later, the IAI Work Plan for Narrowing the Development Gap within the ASEAN (July 2002-June 2008) was approved at the ASEAN Summit Meeting in Cambodia in November 2002. Four priority areas were selected: (1) development of infrastructure; (2) human resources development; (3) information communication technology (ICT) and (4) regional economic integration.

Japan established the Japan-ASEAN Solidarity Fund (ASEAN Foundation) in 1998 and the Japan-ASEAN General Exchange Fund (JAGEF) at the ASEAN Post Ministerial Conference in July 2000. Japan is also providing funding support through the ASEAN Foundation to three IAI HRD projects (jointly financed with Philippines) and one ICT project (jointly financed with Thailand). Japan's support for IAI projects has been continuous. It announced at the Japan-ASEAN Special Summit in December 2003 that was funding six IAI infrastructure projects (total US$500,000) through JAGEF. Japan's Ministry of Health, Labor, and Welfare has agreed to fund a three-year labor and employment project. In addition, Japan also provided the funding for the Japan-ASEAN Collaboration Programme for Strengthening the Basis of Human Resources Development in CLMV (2004-2007). After the Republic of Korea, Japan is the second largest donor country involved in the IAI program.

2.3 Revision of the ODA Charter and the announcement of the New Concept of Mekong Region Development

Japan revised the ODA Charter in 1992 and published a new ODA Charter in August 2003. One of basic policies of the charter is partnership and collaboration with the international community. It mentions the following:

"Japan will actively promote South-South cooperation in partnership with more advanced developing countries in Asia and other regions. Japan will also strengthen collaboration with regional cooperation frameworks, and will support region-wide cooperation that encompasses several countries."

As one of Priority Regions, it mentions the ASEAN as follows:

"In particular, the East Asian region which includes ASEAN is expanding and deepening economic interdependency and has been making efforts to enhance its regional competitiveness by maintaining economic growth and strengthening integration in recent years. ODA will be utilized to forge stronger relations with this region and to rectify disparities in the region, fully considering such factors as the strengthening of economic partnership with East Asian countries."

Japan announced the new initiative for the Mekong Region Development at the Japan-ASEAN Special Summit in December 2003. The integrated approach of economic cooperation and trade-investment facilitation is emphasized in the "New Concept of Mekong Region Development," which stresses three visions: (1) reinforcing regional integration; (2) attaining sustainable economic growth; and (3) harmonizing with the environment (Figure 1). To enhance economic cooperation, Japan announced that it would provide assistance of approximately US$1.5 billion over the next three years for the development of the EWEC and the 2nd East-West Corridor of the GMS Program as well as the improvement of infrastructure (e.g., transport, electricity and

ICT) in the CLV. These would be the priority issues for regional development (Table 4).

At the CLV and Japan Summit held in November 2004 in Laos, the Vientiane Declaration on the Establishment of the Cambodia-Laos-Vietnam Development Triangle was adopted in order to promote multifaceted relations, mutual understanding, and trust among the CLV and to contribute to peace, stability, cooperation, and friendship. Japan supported 16 projects (worth approximately ¥2 billion in total) mainly in the area of basic human needs (BHN), including the above-mentioned US$1.5 billion funding for the New Concept of Mekong Region Development (Table 5).

The New Concept of Mekong Region Development is an attempt at regionwide development mentioned in Japan's ODA Charter. It crosses national borders and targets five countries and one area located in the Mekong river basin, namely, Cambodia, Laos, Myanmar, Thailand, Vietnam, and China's Yunnan Province. Promotion of the Mekong regional development is expected to strengthen relations between the countries in the region; create a more favorable environment for reducing the disparities within the ASEAN by raising the economic levels of the new ASEAN members; and strengthen ASEAN integration (Kazuo Sunaga:2004).

Figure 1: New Concept of Mekong Region Development

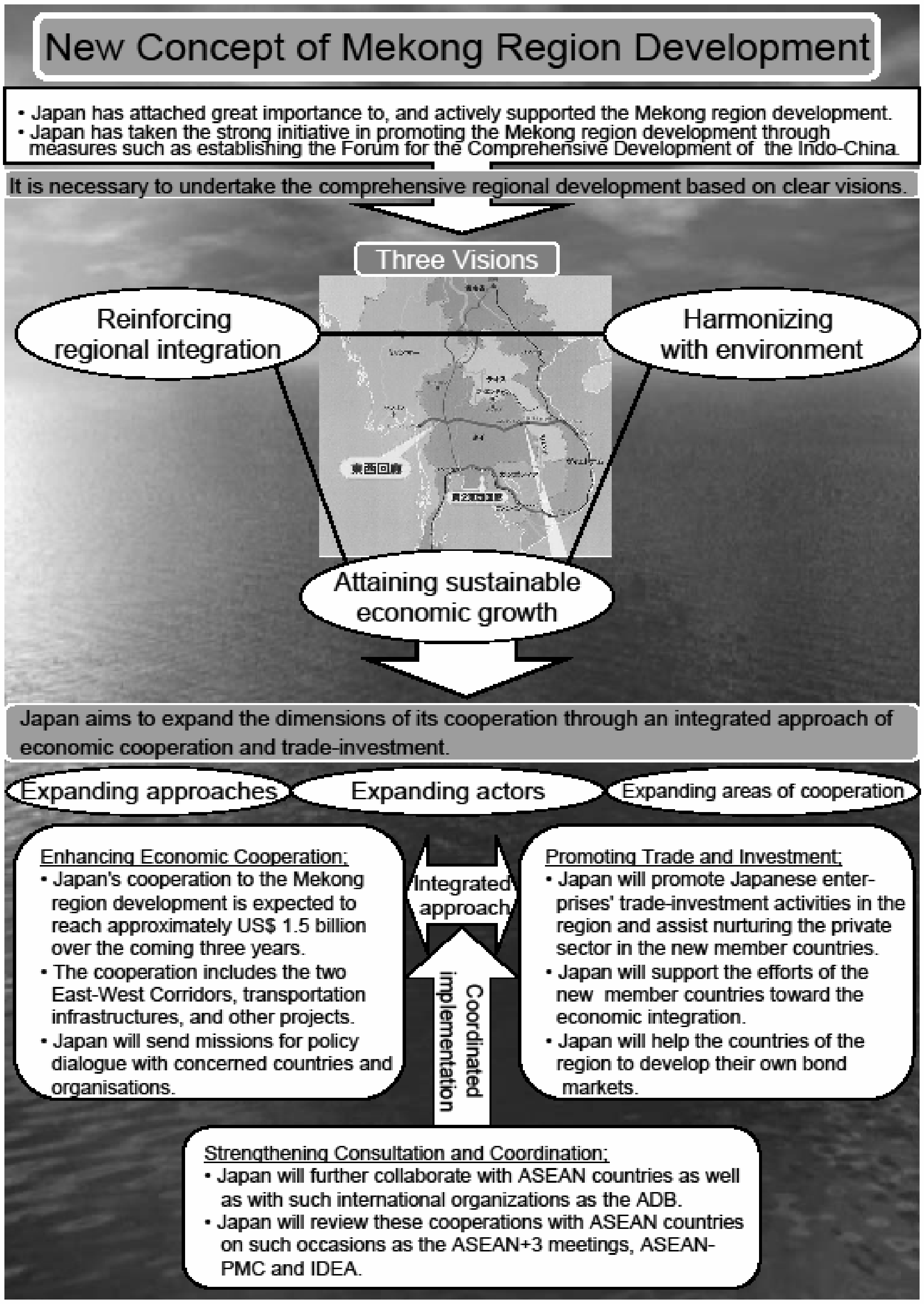


Table 4: Major projects of Japan's Initiative for the Mekong Region Development (2004-2006)

Country	Project Name	Type of ODA	Date of E/N	Amount
	O Mon Thermal Power Plant Unit No.2 Construction Project	yen loan	31-Mar-04	275.47
	Hanoi-Hochiminh Railway Line Bridges Safety Improvement Project	yen loan	31-Mar-04	82.22
Vietnam	Cai Mep-Thi Vai International Port Construction Project	yen loan	31-Mar-05	363.64
	Phan Ri-Phan Thiet Irrigation Project	yen loan	29-Mar-06	48.74
	Small-Scale Pro Poor Infrastructure Development Project (II)	yen loan	29-Mar-06	147.88
	Regional and Provisional Hospital Development Project	yen loan	29-Mar-06	18.05
	Project for Improvement of Safety Laboratory for National Institute of Hygiene and Epidemio	grant aid	28-Sep-06	8.91
Cambodia	Greater Mekong Telecommunications Backbone Network Project	yen loan	16-Mar-05	30.29
	Sihanoukville Port SEZ Development Project	yen loan	1-Mar-06	3.18
	Project of the Improvement of the National Road No.1 in Cambodia	grant aid	12-Jun-06	47.46
	Project for Construction of Primary Schools	grant aid	18-Jun-04	4.25
	Project for Renovation of Technical School for Medical Care	grant aid	11-Aug-04	7.74
Laos	Greater Mekong Power Network Development Project	yen loan	7-Mar-05	33.26
	Project for the improvement of the Vientiane No. 1 Road	grant aid	27-Jul-05	20.92
	Project for the Vientiane Water Supply Development	grant aid	10-Feb-06	0.42
	Project for the Improvement of District Hospitals	grant aid	10-Feb-06	1.50
	Project for the Vientiane Water Supply Development	grant aid	2-Jun-06	28.75
	Project for the Improvement of District Hospitals	grant aid	21-Aug-06	4.13
	Project for Improvement of Maternal and Child Health Care Services (Phase V)	grant aid	1-Mar-04	6.62
	Project for Afforestation in Central Dry Zone	grant aid	9-Jul-04	3.44
Myanmar	Project for Afforestation in Central Dry Zone (Phase II)	grant aid	27-Jun-05	2.93
	Project for Afforestation in Central Dry Zone (Phase III)	grant aid	17-Aug-06	3.30
	Project for Improvement of Maternal and Child Health Care Services (Phase VI)	grant aid	22-Nov-06	3.10
Region Wide technical cooperation with Thailand				1146.20
Thailand	Animal Disease Control in Thailand and neighboring countries	technical cooperation		
	HIV/AIDS Regional Coordination Center Project	technical cooperation		

Source: MOFA, JBIC

Table 5: Assistance for the CLV Development Triangle

Vietnam	The Project for Constructing Dak Joong Irrigation System
	The Project for Equipment Supply to Kon Tum Vocational Training School
	The Project for Constructing Tran Qui Cap Primary School
	The Project for Constructing Kim Dong Primary School
	The Project for Construction Le Dinh Chinh Junior High School in Ea Kenh Commune
	Small-Scale Pro Poor Infrastructure Development Project (II)(Vietnam)
Cambodia	The Project for Well Construction in Ratanakiri Province
	The Project for Labang II Irrigation System Rehabilitation in Ratanakiri Province (Phase II)
	The Project for the Rural Electrification on Micro-Hydropower in Remote Province of Mondul Kir
Laos	Supprting Community Initiative for Primary Education Development in Attapeu & Sekong
	The Project for Construction of Bridge between Kengkaxar Village and Nongfanyong Village

Source: MOFA of Japan.

At the 10th ASEAN-Japan Summit convened in Manila in January 2007, Prime Minister Shinzo Abe announced the expansion of Japan's ODA to the Mekong region for the next three years and the granting of US$41 million to the Japan-ASEAN Integration Fund (JAIF) established in March 2006 as assistance for the development of the CLMV.

3. JAPAN'S ODA TO CLMV COUNTRIES AND THAILAND

3.1 Japan as Top Donor to CLMV Countries

Data from the Organisation for Economic Co-operation and Development (OECD) show that Japan is a top donor to all CLMV countries and Thailand based on the 2004-2005 average of gross ODA. Japan's share of each country's gross ODA are around one-fourth in each country of CLM, nearly 40 percent in Vietnam and over 80 percent in Thailand (Table 6). Multilateral aid agencies like the World Bank or the ADB are usually the next largest donors. In Myanmar, however, UN aid agencies are the major donors. Aside from Japan, Australia is listed as one of the top ten bilateral donors to all CLMV countries and Thailand. Australia also supports the promotion of regionwide cooperation in the Mekong region and provided funding for the first Thai-Lao Friendship Bridge over the Mekong. This bridge, which was opened in 1994, links the Thai province of Nong Khai and the Lao PDR capital of Vientiane. Australia seems to have a very clear cooperation strategy with the CLMV countries.[2]

Table 6: Top Ten Donors of Gross ODA, 2004-05 average. (in million US$)

Cambodia			Laos			Myanmar			Viet Nam			Thailand		
Japan	94	22.4%	Japan	65	25.3%	Japan	26	24.8%	Japan	670	37.5%	Japan	765	83.5%
AsDF	84	20.0%	AsDF	58	22.6%	EC	14	13.3%	IDA	418	23.4%	Germany	31	3.4%
US	60	14.3%	IDA	42	16.3%	UK	11	10.5%	AsDF	207	11.6%	France	27	2.9%
IDA	43	10.2%	France	21	8.2%	Australia	11	10.5%	France	116	6.5%	EC	19	2.1%
France	28	6.7%	Sweden	19	7.4%	UNDP	10	9.5%	UK	82	4.6%	GFATM	19	2.1%
Australia	27	6.4%	Germany	15	5.8%	UNICEF	8	7.6%	Germany	79	4.4%	Denmark	17	1.9%
Germany	24	5.7%	Australia	12	4.7%	Korea	7	6.7%	Denmark	73	4.1%	US	16	1.7%
Korea	21	5.0%	EC	10	3.9%	Norway	6	5.7%	Netherlan	55	3.1%	Australia	8	0.9%
UK	20	4.8%	Luxembour	8	3.1%	GFATM	6	5.7%	Australia	50	2.8%	Canada	7	0.8%
Sweden	19	4.5%	Korea	7	2.7%	UNTA	6	5.7%	EC	35	2.0%	Norway	7	0.8%
	420	100.0%		257	100.0%		105	100.0%		1785	100.0%		916	100.0%

Source: Organisation for Economic Co-operation and Development (OECD).

Large-scale assistance from Japan to the Mekong region started in 1991.Vietnam received total ¥1,209,778 million through Japan's ODA between fiscal years (FY) 1991 and 2005. Thailand received ¥1,337,842 million in the same period. On the other hand, Cambodia received ¥155,774 million; Laos, ¥130,687 million; and Myanmar, ¥97,193 million (Table 7). It is clear that Japan's ODA to Vietnam is almost ten times bigger compared to those extended to other CLM countries. The difference comes from the received amount of ODA loans. Many large-scale projects in Thailand and Vietnam are financed with yen loans. As for economic assistance to the "Mekong Region

[2] Watanabe (2004) had a comparison analysis of the regional cooperation projects by JICA and AusAID. It was found that JICA's approach had more limited impact compared with AusAID.

Development Projects," the largest amount went to the airport sector, followed by road, harbor, and bridge sectors.

3.2 Japan's ODA by Country

Vietnam

Vietnam's economy has rapidly expanded since the introduction of the Doi Moi policy in 1986. Large-scale assistance through ODA loans began in 1992. Since 1995, Japan has been the largest donor country to Vietnam.

The present medium-term strategy of Japan's ODA loan to Vietnam has two pillars: (1) sustained economic growth and increased international competitiveness built on private sector development and (2) rectification of regional gaps, poverty reduction, and improvement of the standard of living. Additionally, high priority is placed on policy and institutional reform, environmental countermeasures, and human resource development. Social development projects have the largest allocation in the technical assistance program of the Japan International Cooperation Agency (JICA) to Vietnam.

Laos

Laos also adopted a reform and liberalization policy in 1986. Initial assistance involved technical cooperation for the construction of Luang Prabang Hospital, feasibility studies for the construction of the Vientiane Airport, and the rehabilitation of the Namgum Dam. After this, assistance to Laos was extended mainly in the form of grant-based assistance and technical cooperation. In JICA's technical assistance program for Laos, human resources development accounts for a uniquely large proportion of projects at roughly 20 percent, around the same percentage as social development and rural development.

Table 7: Japan's ODA to CLMV countries (in million Japanese yen)

		Cambodia	Laos	Myanmar	Vietnam	Thailand
yen loan	1959-1990	1,517	5,190	402,972	40,430	833,011
(E/N basis)	1991-2000	4,142	3,903	0	651,989	1,079,862
	2001	0	4,011	0	74,314	6,405
	2002	0	0	0	79,330	45,170
	2003	0	0	0	79,330	44,852
	2004	7,342	3,326	0	82,000	0
	2005	318	0	0	90,820	35,453
	2006	2,632	500	0	104,078	0
	sub-total	15,951	16,930	402,972	1,202,291	2,044,753
grant aid	1959-1990	2,637	23,214	97,594	31,292	141,324
(E/N basis)	1991-2000	68,627	58,030	67,888	58,681	15,825
	2001	7,645	7,003	5,993	8,371	315
	2002	10,306	6,567	2,162	5,237	354
	2003	6,250	4,111	992	5,650	431
	2004	6,693	3,017	909	4,914	501
	2005	6,909	4,235	1,717	4,465	236
	2006	9,025	6,909	640	1,964	0
	sub-total	118,092	113,086	177,895	120,574	158,986
technical	1959-1990	1,706	4,613	15,097	2,449	91,807
cooperation	1991-2000	16,769	20,121	6,674	33,111	83,285
(JICA only)	2001	4,306	4,486	3,319	7,909	6,925
	2002	4,037	3,545	2,794	6,708	5,677
	2003	3,755	2,983	1,658	5,577	4,296
	2004	4,082	2,773	1,446	5,711	4,702
	2005	4,593	2,576	1,641	5,661	3,553
	2006	4,042	2,382	1,725	5,275	2,960
	sub-total	43,290	43,479	34,354	72,401	203,205
	1959-1990	5,860	33,017	515,663	74,171	1,066,142
	1991-2006	171,473	140,478	99,558	1,321,095	1,340,802
Whole ODA	total	177,333	173,495	615,221	1,395,266	2,406,944

Source: MOFA of Japan

Japan has been the largest bilateral donor to Laos since 1991. Its cooperation is focused mainly in the areas of human resources development, BHN, agriculture and forestry, and industrial infrastructure. In recent years, assistance was provided to promote private investment and trade as well as tourism development because Laos aims to participate in the ASEAN Free Trade Area (AFTA) by 2008.

Cambodia

In 1991, after the conclusion of a peace agreement, Japan's Self-Defense Force took part in the United Nations' peace-keeping operations in Cambodia from 1992 to 1993, and its ODA resumed primarily in the form of grant-based assistance and technical cooperation. Social development has the largest allocation in JICA's technical assistance to Cambodia.

In the infrastructure sector, restoration of national roads, Routes 6 and 7, and rehabilitation of the Phnom Penh Port were implemented with grant-based assistance. In response to the 3rd Consultative Group Meeting for Cambodia held in Tokyo in 1999, Japan extended an ODA loan for the urgent rehabilitation project of Sihanoukville Port at the request of the Cambodian Government. Japan has contributed greatly to the realization of peace in Cambodia.

Assistance is also provided to Phnom Penh, the country's capital, and Shihanoukville as the growth corridor for infrastructure improvement and policy system reforms. These reforms are expected to invigorate private economic activities in the region and lay the foundations that should contribute to the sustained growth of the tourism industry, a source of precious foreign currency income. Cambodia succeeded in joining the World Trade Organization (WTO) in 2004, paving the way for its integration in the international economy.

Myanmar

Japan suspended economic cooperation with Myanmar, in principle, following the military coup d'etat in 1988. The only exception was grant aid for debt relief which was based on a 1978 resolution of the Trade and Development Board (TDB) of the United Nations Conference on Trade and Development (UNCTAD). Japan has been providing debt-relief measures in the form of grant aid equal to the total amount of the principal and interest on government loans prior to fiscal year 1987 with respect to repayments from Myanmar (with the result that net payments are zero). In addition, when Aung San Suu Kyi was released from house arrest in July 1995, the Japanese Government reviewed its aid policy toward Myanmar and decided to reconsider and implement suspended ongoing projects, including projects that would directly benefit the people of Myanmar by addressing their basic human needs (BHN), on a case-by-case basis while monitoring democratization and the improvement of human rights.

In the absence of progress toward democratization and human rights improvements, however, Japan's assistance to Myanmar is limited to small-scale, grassroots assistance through nongovernmental organizations (NGOs). Development assistance extended to Myanmar is the lowest among the GMS countries.

3.3 JICA's South-South Cooperation and Thailand

JICA has supported South-South Cooperation with two schemes: the Third-Country Training Program initiated in 1975 and the Third-Country Expert Program in 1995.

Among the ASEAN countries, there are already countries that no longer need ODA based on the definition of the OECD-Development Assistance Committee (OECD-DAC). These countries are Singapore and Brunei. There are also some countries at a relatively advanced stage of economic development like Thailand and Malaysia. Overall, the ASEAN member countries have accumulated a variety of experience and knowledge on economic development. For this reason, agreements have been made to actively advance South-South Cooperation.

Japan concluded its partnership programs with Singapore and Thailand in 1994. The South-South Cooperation to CLMV with the latter as recipient countries was implemented through these programs. CLMV, however, suggested that the support provided failed to match their needs. JICA, therefore, introduced the JICA-ASEAN Regional Cooperation Meeting (JARCOM) in 2002 to align donor countries' resources with recipient countries' needs. JARCOM's main aim is to form south-south cooperation and regional cooperation projects to redress intraASEAN disparities.

Thailand used to be one of the assistance-receiving countries in the Mekong region, but in recent years, it has also become a donor country extending assistance to other countries in the basin through the Ayeyawady-Chao Phraya-Mekong Economic Cooperation Strategy (ACMECS) established in 2003. In this manner, Japan cooperates with Thailand as a fellow donor country through the South-South Cooperation scheme.

4. KEY CHALLENGES AND DIRECTION FOR REGIONWIDE COOPERATION

The New Concept of Mekong Region Development announced in 2003 is an attempt at regionwide development mentioned in Japan's ODA Charter. It crosses national borders and targets five countries and one area located in the Mekong river basin; namely, Cambodia, Laos, Myanmar, Thailand, Vietnam, and China's Yunnan Province. Promotion of the Mekong Region Development is expected to strengthen relations between countries in the region and create a more favorable environment for reducing disparities within the ASEAN by raising the economic levels of the new members located in this region. Among other things, it is also expected to strengthen ASEAN integration.

As regionwide development is a new challenge under the Japanese bilateral ODA, the following difficulties and recommendations have been identified based on a review of existing papers:

(1) Regionwide development may cause a growth gap between countries or areas that can enjoy the benefits of development and those unable to access such benefits. Therefore, countermeasures to alleviate such a gap must be prepared even if the emergence of such a gap is unavoidable in the process of economic growth. It is important to provide support, such as social welfare, to areas that cannot receive the benefits of regionwide development through close coordination.

(2) When providing public goods under regionwide development, it is possible to create a difference of priorities between regional public goods and domestic public goods in each country. It is important for Japan to present a clear regionwide development strategy and to make a master plan in the Mekong region through policy negotiations in order to provide regional public goods efficiently and effectively. It is especially important in the fields of navigation, disaster prevention, water utilization, and environmental conservation in the Mekong River to coordinate the interests of

upstream and downstream areas as well as right and left banks where conflicts naturally tend to occur.

(3) To advance a regionwide development vision and strategy, sharing of information and cooperation with international organizations such as the ADB and the Mekong River Commission (MRC) must be started from the policy formulation and planning stages. It is essential for Japan to actively make technical proposals and offer information. It is also important to decide on a regionwide development strategy and financial sharing arrangement in an integrated manner and in cooperation with other donors on a long-term basis.

(4) To carry out a regionwide development project such as the Mekong Region Development, a long-term effort and a flexible approach are required as socioeconomic changes occur very quickly in this region where the speed of growth is very fast. Development vision, priority projects, and other development-related matters should be reviewed periodically and then advanced again with necessary modifications by paying attention to changes in private investment and physical distribution in the region.

(5) For efficient and effective regionwide cooperation, it is necessary to provide comprehensive assistance, including improvements in policies, institutions, and maintenance in order to solve various problems. It is also essential to advance assistance efforts by interlinking ODA loans, grant aids, and technical cooperation organically.

(6) Development of border areas is key to regionwide development. Japan has implemented several development studies, such as the Integrated Development Plan for the Border Region (Laos and Thailand) and the Study on Special Economic Zone Development Plan in Border Area (Savannakhet Province in Laos). To effectively promote a regionwide development project spanning multiple countries in the Mekong region, it is necessary to allocate some amount out of the total budget appropriated for bilateral assistance in each country to a regionwide project having cross-border effects.

(7) Cooperation with the private sector should be thoroughly considered for the efficient operation of infrastructure and for the promotion of market enhancement. In the case of the Cai Mep-Thi Vai International Port Construction Project in Vietnam, operation of the new port facilities will be entrusted to private-sector operators to ensure efficient operations and maintenance management. In general, ODA loans should be used for market enhancement measures in commercially nonviable fields because private participation is available in fields where commercial viability has been realized by market enhancement measures.

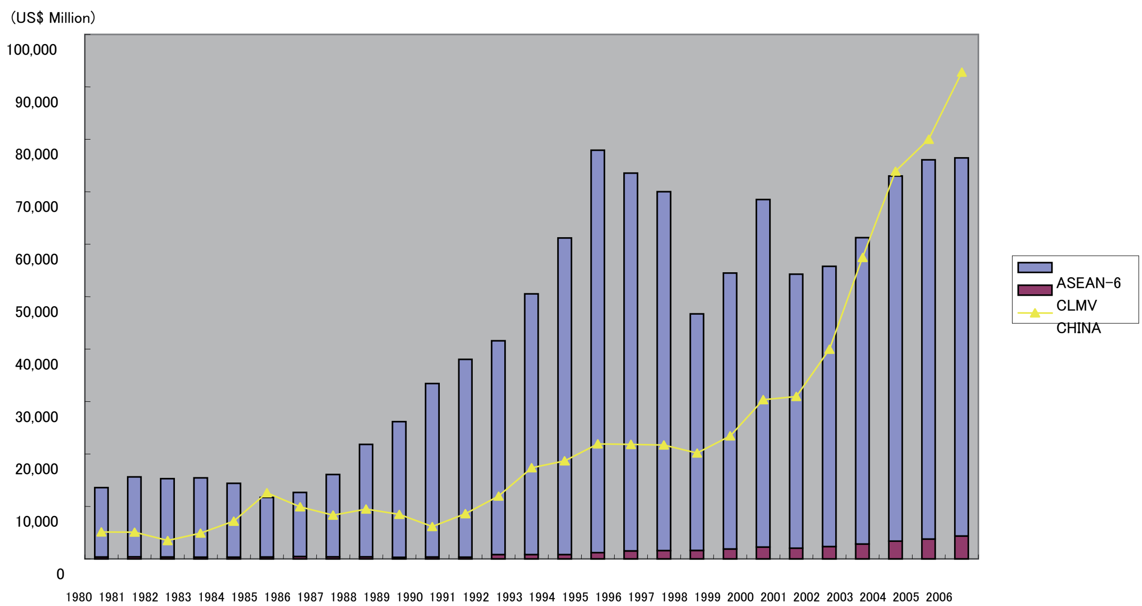
5. JAPAN’S TRADE AND INVESTMENT WITH CLMV

While Japan is the top donor country for all CLMV countries, its trade and investment relations are quite weak. In this section, the authors examine the trade and investment performance between Japan and CLMV.

5.1 Japan's Trade with CLMV

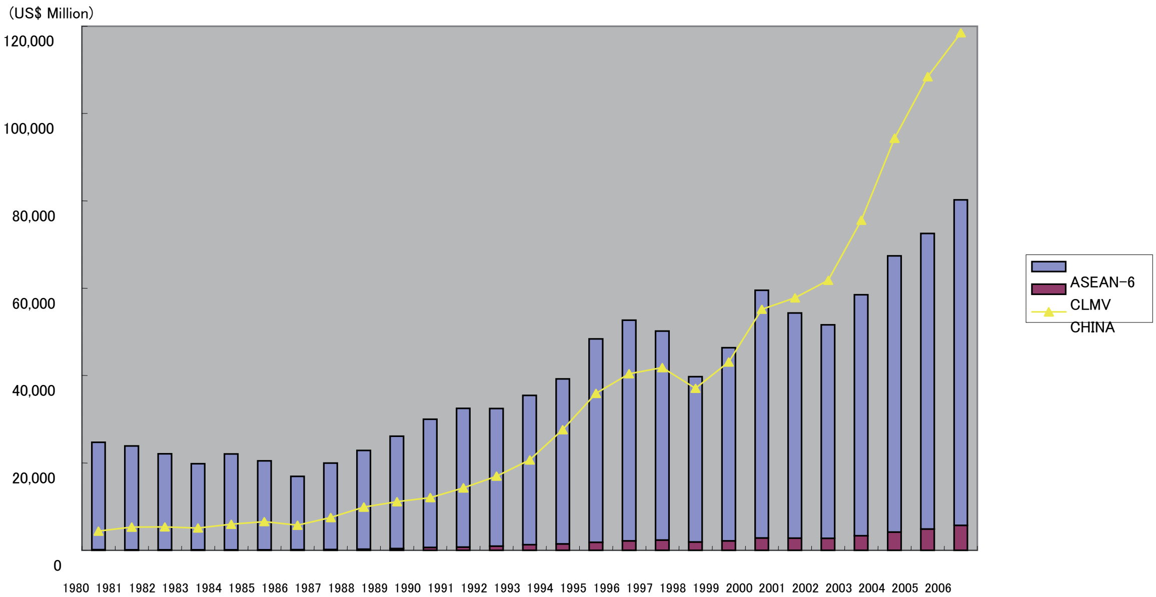
Bilateral trade between Japan and the ASEAN grew in the 1990s and up to 2006 in spite of a temporary decline after the Asian Financial Crisis of 1997. Japan's exports to the ASEAN increased by 2.3 times from US$ 33,406 million in 1990 to US$ 76,434 million in 2006. Its imports from the ASEAN increased by 2.7 times, from US$ 29,975 million in 1990 to US$ 80,197 million in 2006. The ASEAN is an important trading partner of Japan, accounting for 11.8 percent of Japan's total exports and 13.9 percent of its total imports in 2006.

Figure 2: Japan's Exports to ASEAN and China



(Source) IMF, *Direction of Trade*.

Figure 3: Japan's Imports from ASEAN and China

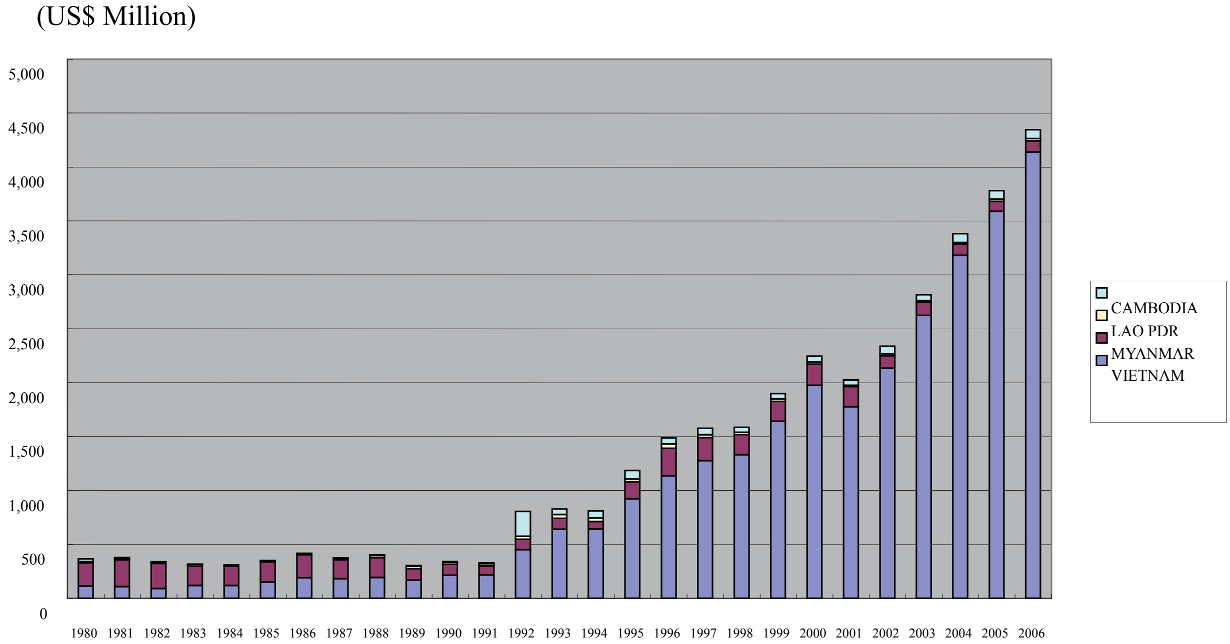


(Source) IMF, *Direction of Trade.*

However, the bulk of trade between Japan and the ASEAN happens between Japan and the original six ASEAN members while the four new ASEAN member countries, i.e., CLMV, account for only a small share. CLMV occupied only 5.7 percent in Japan's exports to the ASEAN and 7.2 percent in Japan's imports from the ASEAN. CLMV have not yet become major trading partners of Japan.

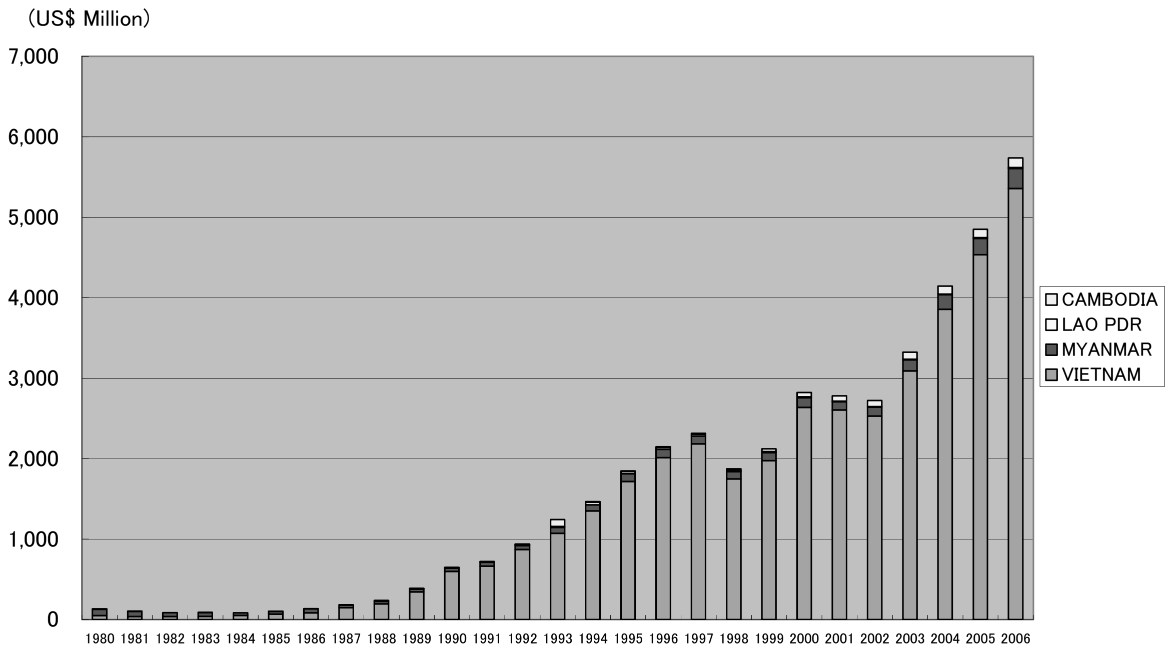
Moreover, Vietnam alone assumed a lion's share of Japan's trade with CLMV, occupying 95.3 percent in Japan's exports to CLMV and 93.4 percent in its imports from CLMV in 2006. In other words, Cambodia, Laos, and Myanmar have yet to become significant trading partners for Japan.

Figure 4: Japan's Exports to CLMV



(Source) IMF, *Direction of Trade*.

Figure 5: Japan's Imports from CLMV



(Source) IMF, *Direction of Trade*.

Among the CLMV, Vietnam and Cambodia showed a brisk performance in their trade with Japan while Laos and Myanmar recorded rather dismal figures. Japan's exports to Vietnam increased by 19.3 times from US$ 214 million to US$ 4,140 million for the period between 1990 and 2006. Japan's imports from Vietnam increased nine times for the same period from US$ 597 million to US$ 5,358 million. Japan's exports to Cambodia increased by 17.9 times from US$ 5 million to US$ 82 million while its imports from Cambodia expanded 34.2 times from US$ 3 to US$ 119 for the same period.

On the other hand, Japan's exports to Laos stagnated from US$ 20 million in 1990 and US$ 21 million in 2006 while its imports from Laos increased from US$ 5 million in 1990 to US$ 12 million in 2006. Japan's exports to Myanmar also stagnated at US$ 101 million in 1990 and US$ 104 million in 2006, while its imports from that country showed a steady increase from US$ 42 million in 1990 to US$ 248 million in 2006.

5.2 CLMV's Trade Dependency on Japan

Although Japan is currently not a major trading partner of CLMV, it was a relatively important trading partner for CLMV in 1990. Approximately 7 percent of Cambodia's, Laos's, and Myanmar's total exports went to Japan while Vietnam exported 13.5 percent of its total exports to Japan in 1990 (Table 8). However, all CLMV countries reduced their export shares to Japan in 2006. Cambodia and Laos exported only 1 percent and Myanmar only about 5 percent of their total exports to Japan in 2006. Only Vietnam exported more than 12 percent of its total exports to Japan in the same year.

Table 8: CLMV's Trade Dependence on Japan, China, and the United States

CLMV's Trade with Japan

	Exports		Imports	
	1990	2006	1990	2006
Cambodia	7.6%	1.0%	9.0%	4.3%
Laos	7.1%	1.0%	14.5%	1.4%
Myanmar	6.9%	5.2%	16.6%	3.0%
Vietnam	13.5%	12.3%	5.9%	9.5%

CLMV's Trade with China

	Exports		Imports	
	1990	2006	1990	2006
Cambodia	1.2%	15.7%	9.1%	26.5%
Laos	9.1%	4.1%	11.6%	12.3%
Myanmar	13.7%	6.4%	21.9%	35.8%
Vietnam	9.9%	7.1%	7.1%	20.6%

(Note) Including Hong Kong.

CLMV's Trade with the United States

	Exports		Imports	
	1990	2006	1990	2006
Cambodia	0.0%	53.3%	0.0%	0.9%
Laos	0.1%	0.8%	0.7%	0.5%
Myanmar	2.3%	0.0%	2.9%	0.2%
Vietnam	0.0%	21.3%	0.0%	2.5%

(Source) IMF, Direction of Trade.

CLM's import dependence also substantially declined. Japan's share in Cambodia's total imports declined from 9 percent in 1990 to 4.3 percent in 2006 while its share in Laos's total imports shrank from 14.5 percent in 1990 to 1.4 percent in 2006. Myanmar followed the same trend, i.e., 16.6 percent in 1990 to 3 percent in 2006. Vietnam is the only exception; it increased its import dependence on Japan from 5.9 percent in 1990 to 9.5 percent in 2006.

The U.S. opened its markets to Cambodia and Laos, in particular. It absorbed more than a half of Cambodia's total exports, mainly garments, and more than 20 percent of Vietnam's total exports in 2006, although there were no imports from the United States from the two countries in 1990. On the other hand, China emerged as a major supply source of commodities and goods to CLMV. China increased its share in Cambodia's total imports from 9.1 percent in 1990 to 26.5 percent in 2006. It also increased its share in Laos's total imports from 11.6 percent in 1990 to 12.3 percent in 2006. China supplied more than one-third of Myanmar's total imports in 2006, which was about 20 percent in 1990. China's share in Vietnam's total imports also increased from 7.1 percent in 1990 to 20.6 percent in 2006. On the whole, Japan has reduced its relative importance in CLMV's external trade while the United States and China have played a more active role.

Nevertheless, the relative slow development of trade between Japan and CLMV in the 1990s does not necessarily mean it has continued to stagnate in recent years. Japan started to open its markets to CLMV's products by providing the Generalized System of Preferences (GSP), development-and-import-formula business activities, and making FDIs in these countries. Since 2003, Cambodia, Myanmar, and Vietnam have shown double- digit growth rates in their bilateral trade with Japan although Laos had shown ups and downs (Table 9). Such a trend is encouraging for both CLMV and Japan. Japanese markets can contribute more to CLMV trade and industrial development in the near future.

Table 9: Growth of Japan's Imports from CLMV

Rank	Country	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
	World Total	21.9%	3.9%	-3.0%	-17.1%	11.1%	21.7%	-8.0%	-3.2%	13.4%	18.9%	13.3%	12.1%	7.5%
1	China	29.6%	12.5%	3.6%	-11.3%	16.4%	27.6%	4.9%	7.1%	22.1%	25.0%	15.0%	9.1%	7.9%
24	Vietnam	26.6%	17.2%	8.7%	-20.0%	13.0%	33.4%	-1.3%	-2.7%	22.0%	25.0%	17.4%	16.6%	15.7%
64	Myanmar	22.9%	9.9%	-3.9%	-9.3%	13.5%	17.5%	-14.5%	8.2%	26.5%	29.0%	13.0%	20.5%	20.7%
81	Cambodia	-16.5%	-10.3%	100.6%	21.5%	117.3%	49.9%	26.8%	13.3%	18.9%	11.8%	6.2%	13.3%	15.7%
134	Laos	-3.9%	-20.8%	-10.2%	-7.8%	-30.9%	-11.2%	-42.3%	-2.9%	9.8%	8.7%	0.1%	53.3%	-3.1%

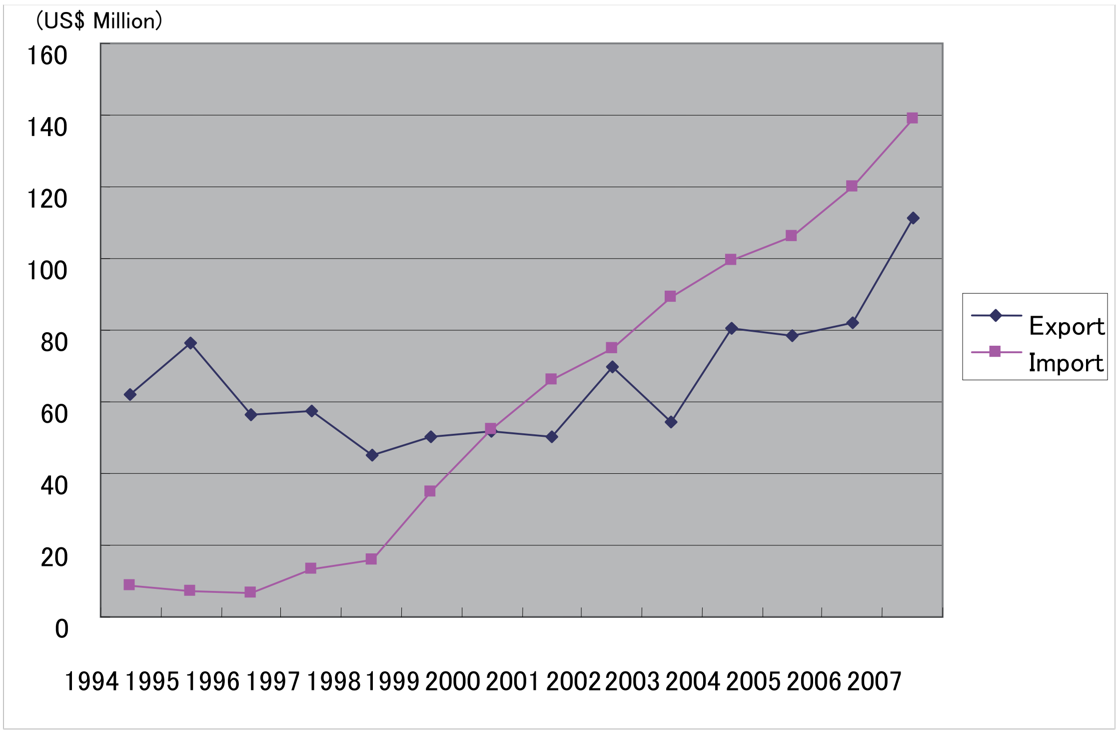
(Source) Japan Customs.

5.3 Japan's Trade with Each CLMV

5.3.1 Japan's Trade with Cambodia

Cambodia is not a major trading partner for Japan since it was ranked 106th in terms of export and 81st in terms of import among more than 200 of Japan's trading partners. However, Japanese trade with Cambodia steadily increased after 2000 for both imports and exports. Japan's imports from Cambodia sharply increased after 1998, although it had been insignificant during the previous years.

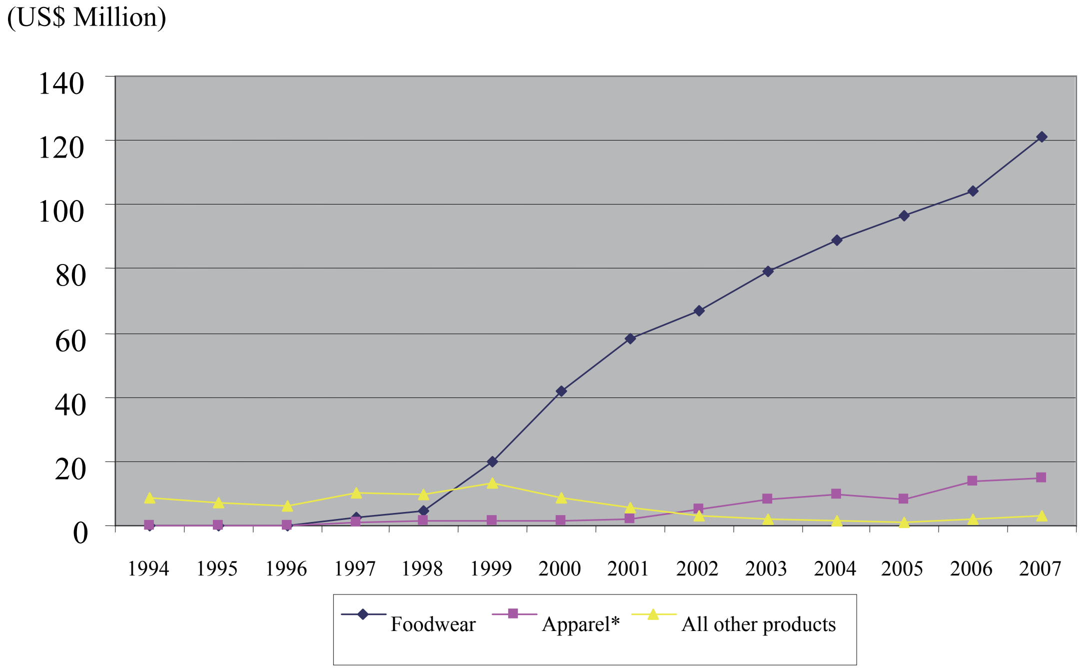
Figure 6: Japan's Trade with Cambodia



Source: World Trade Atlas.

Japanese imports from Cambodia have been historically dominated by forest products, although these were successfully replaced by footwear after 1998. Therefore, the increase in Japan's imports from Cambodia was due to Cambodia's rapid increase in footwear exports. At the same time, the volume of all other products gradually decreased to a very low level. Cambodia's exports of apparel products also gradually increased after 2002.

Figure 7: Japan's Import from Cambodia by Commodity

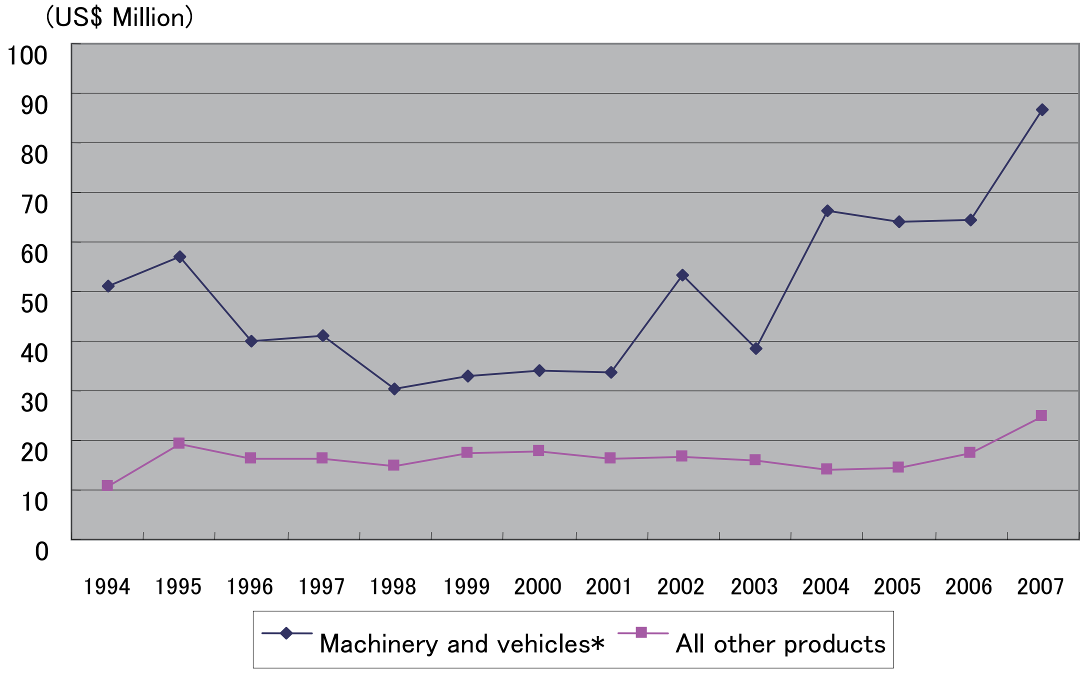


Note*= Apparel products include knit apparel and woven apparel.

Source: World Trade Atlas.

In terms of Japanese exports to Cambodia, machineries and vehicles dominated all other products. Even though the share of this product category decreased between 1996 and 2003, it increased dramatically again after 2003. The volume of all other export products remained stagnant between US$10 million and US$20 million per year.

Figure 8: Japan's Export to Cambodia by Commodity



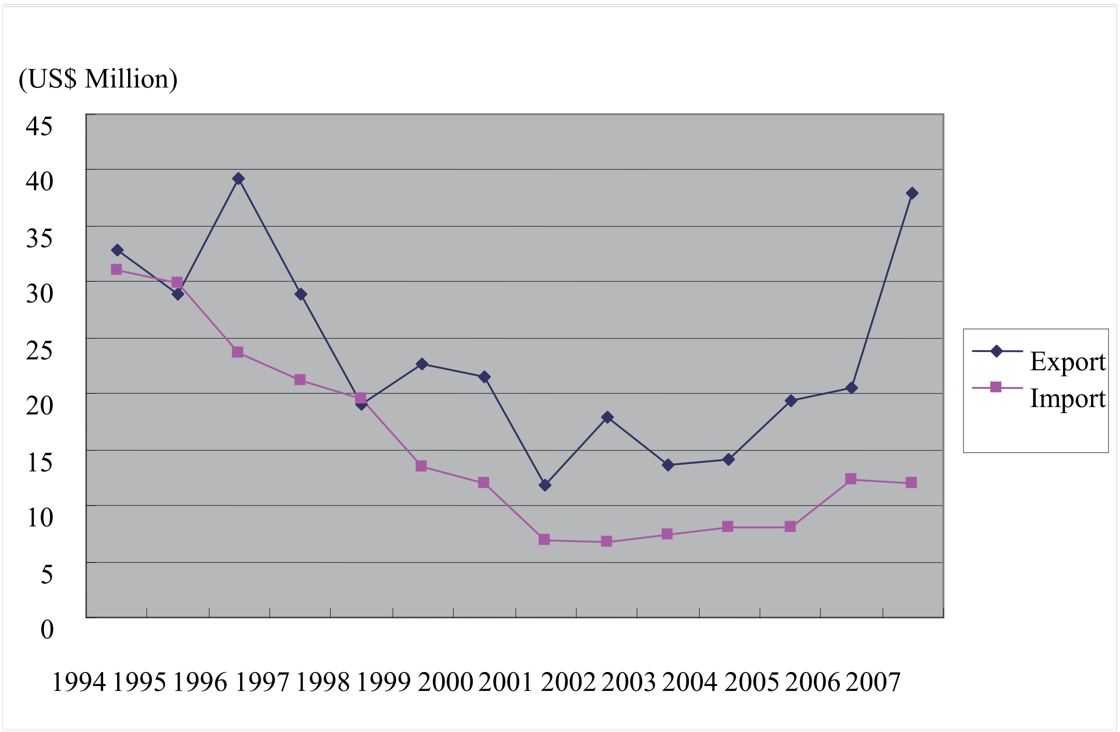
Note: *The category machineries and vehicles include electronic machineries, railway, ships, boats, and aircraft.

Source: World Trade Atlas.

5.3.2 Japan's Trade with Laos

Among the CLMV, Laos is the least significant trading partner for Japan. Laos was ranked 134th for import and 135th for export among Japan's trading partners. Although Japan's trade with Laos has been small, Japan enjoyed a trade surplus in almost all periods under consideration. In Figure 9, it can be seen that Japan's trade with Laos decreased from 1994 to 2001 for both exports and imports, but Japanese exports gradually increased from 2003 afterwards.

Figure 9: Japan's Trade with Laos

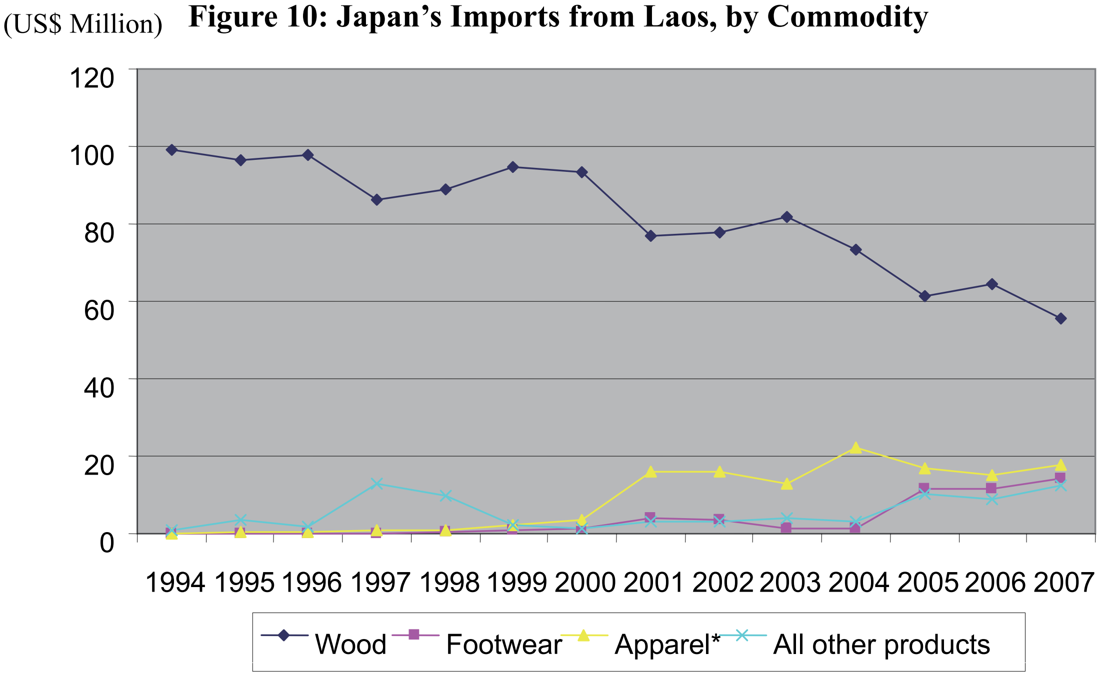


Source: World Trade Atlas.

Figure 10 shows Japan's imports from Laos for the period from 1994 to 2007. It can be seen that only one product (i.e., wood) dominated Japan's imports from Laos. However, this gradually decreased year after year throughout the period while exports of apparel, footwear, and all other products gradually increased.

Figure 11 shows Japan's exports to Laos by commodity groups. Not surprisingly, Japan's major exports to Laos were electronic and machinery products, the volume of which gradually declined from 1994 to 2004, but sharply increased again afterwards. The volume of all other products remained stagnant around US$ 10 million per year throughout the period.

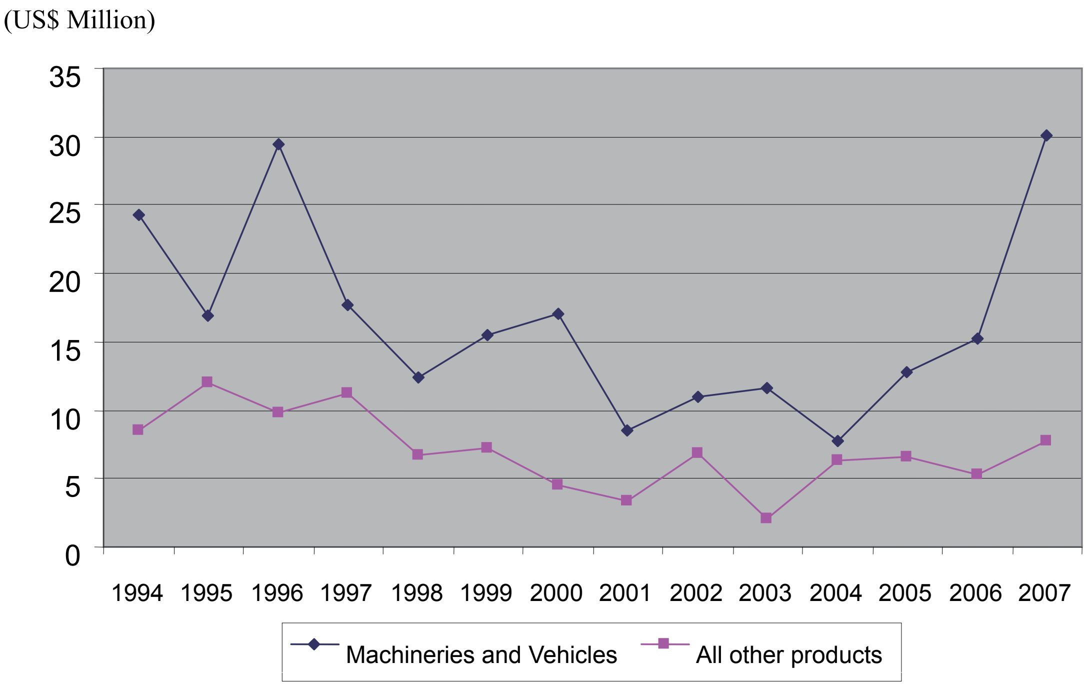
Figure 10: Japan's Imports from Laos, by Commodity



Note:*Apparel include knit apparel and woven apparel.

Source: World Trade Atlas.

Figure 11: Japan's Exports to Laos, by Commodity

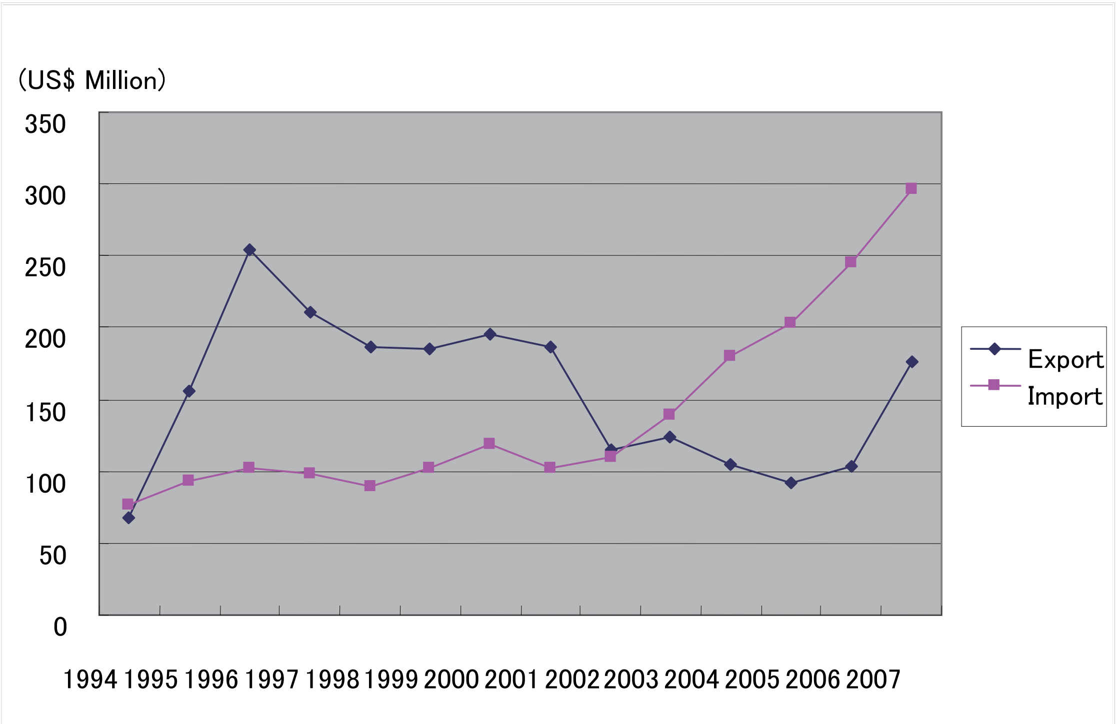


Source: World Trade Atlas.

5.3.3 Japan's Trade with Myanmar

Japan's trade with Myanmar is the second largest in CLMV after Vietnam. Myanmar ranked 64th in terms of Japan's imports and 89th for exports. Japan enjoyed a trade surplus with Myanmar up to 2002. However, this situation was reversed in 2003 when imports from Myanmar sharply increased while exports gradually declined.

Figure 12: Japan's Trade with Myanmar

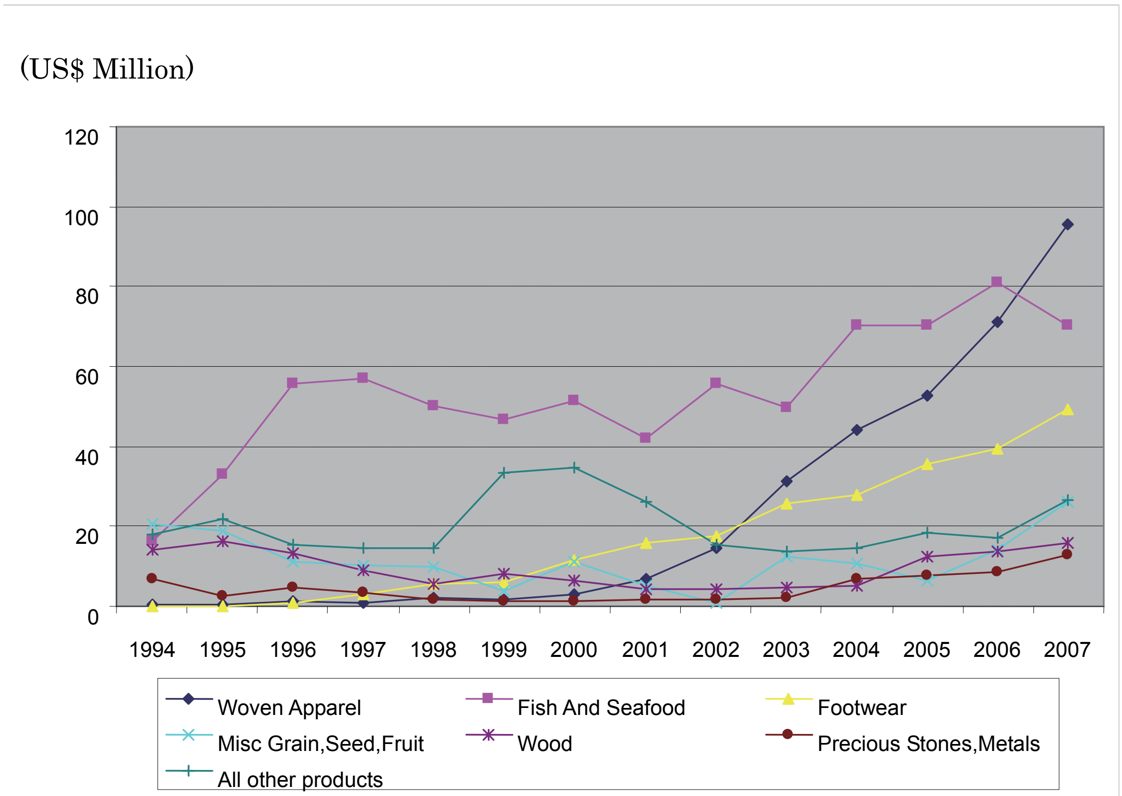


Source: World Trade Atlas.

Japan's imports from Myanmar by commodity groups are shown in Figure 13. Fish and seafood had long occupied a large share of Japan's imports from Myanmar. The volume of fish and seafood still represents significant amount of Japanese imports from the country. After 2002, woven apparel and footwear accounted for a bigger share of

Japan's imports. Specifically, the volume of woven apparel products imported by Japan from Myanmar sharply increased after 2003; this trend is expected to continue in the future. It surpassed the imports of fish and seafood in 2007. Wood, precious stones, and all other products imported from Myanmar remained under US$ 20 million per year.

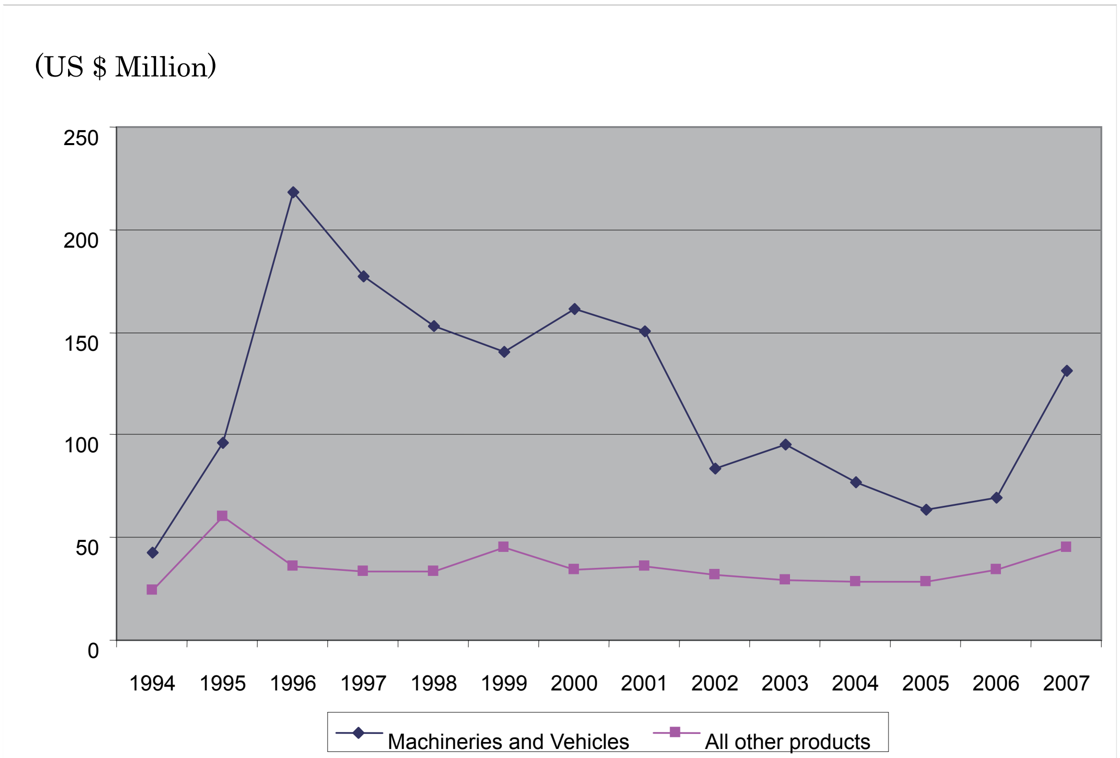
Figure 13: Japan's Imports from Myanmar, by Commodity



Source: World Trade Atlas.

On the other hand, Japan's exports of machineries and vehicles to Myanmar were the same as for the other CLMV countries.

Figure 14: Japan's Exports to Myanmar



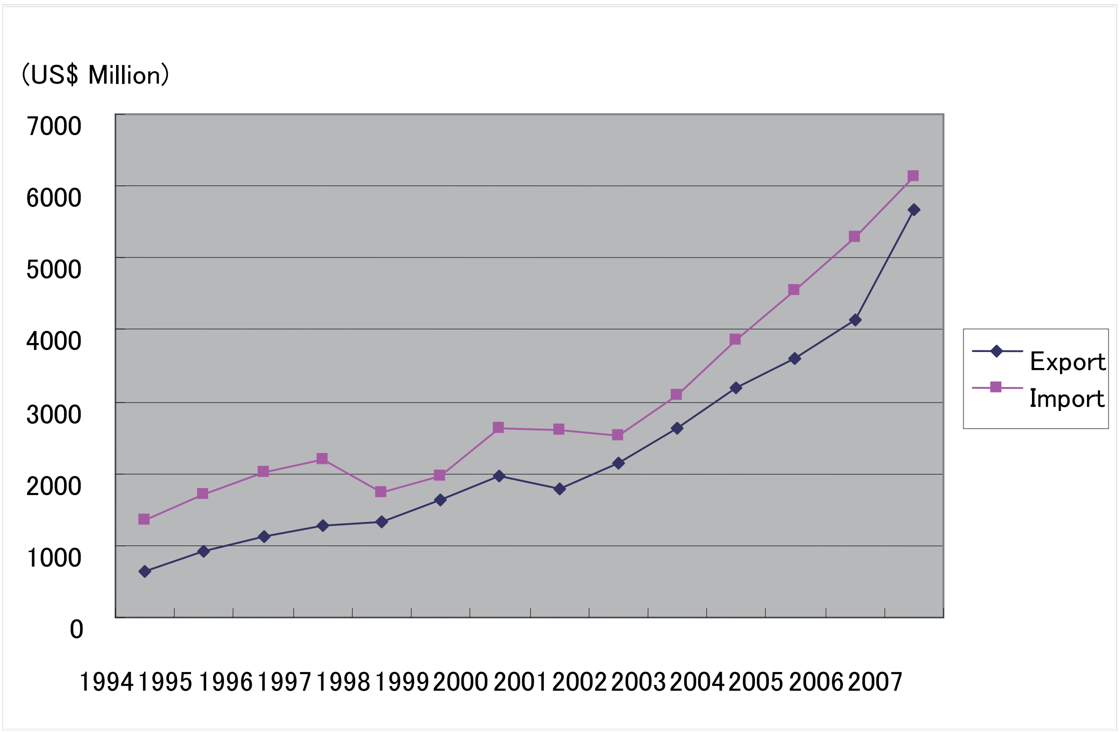
Source: World Trade Atlas.

5.3.4 Japan's Trade with Vietnam

Vietnam is a major trading partner for Japan in terms of exports and imports. It was ranked 24th in Japanese imports and 25th in Japanese exports. Japan's imports from Vietnam represented more than 90 percent of Japan's imports from CLMV while its exports to Vietnam accounted for over 80 percent of Japan's exports to CLMV.

Japan's trade relations with Vietnam strengthened since 2002 for both imports and exports. Even though imports and exports show an upward trend, Japan's imports from Vietnam have been always greater than its exports to Vietnam.

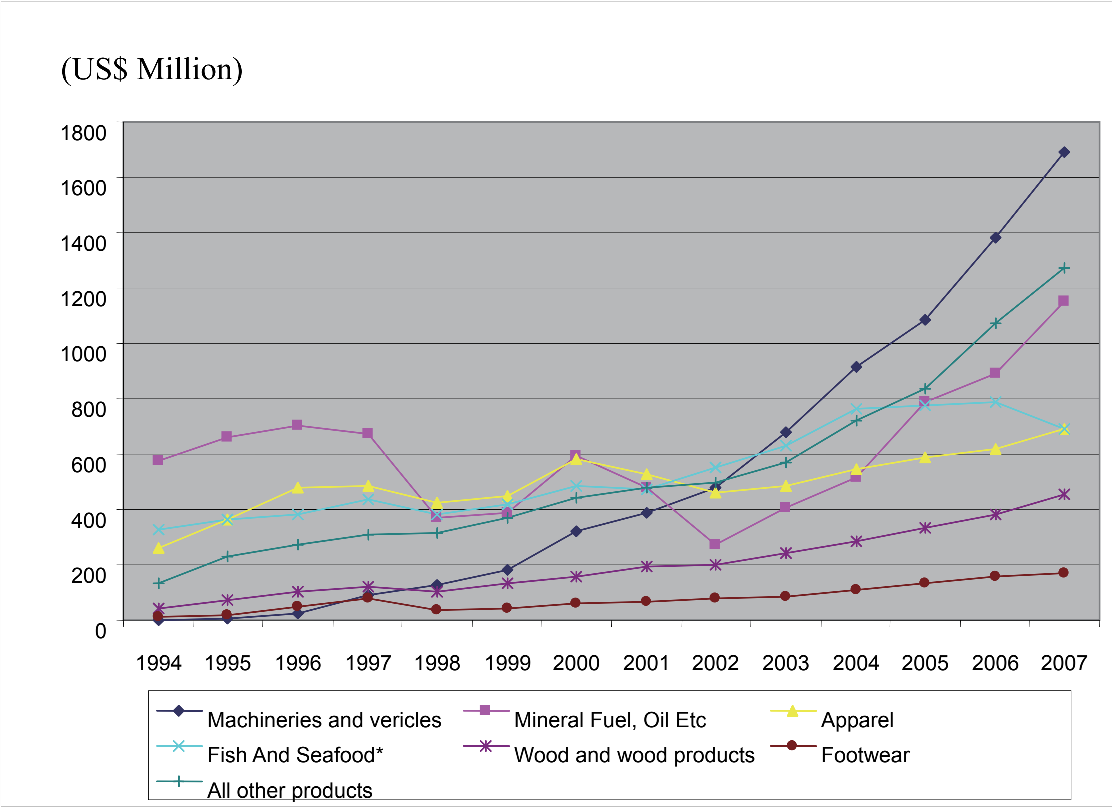
Figure 15: Japan's Trade with Vietnam



Source: World Trade Atlas.

As seen in Figure 16, mineral and fuel, fish and seafood, and apparel products played a dominant role in Japanese imports from Vietnam up to 2002. However, starting 1998, the volume of machinery and vehicle products increased remarkably and surpassed all other imported products after 2002. Vietnam was the only country in CLMV that could export capital and intermediate products like machinery and vehicles to Japan.

Figure 16: Japan's Imports from Vietnam

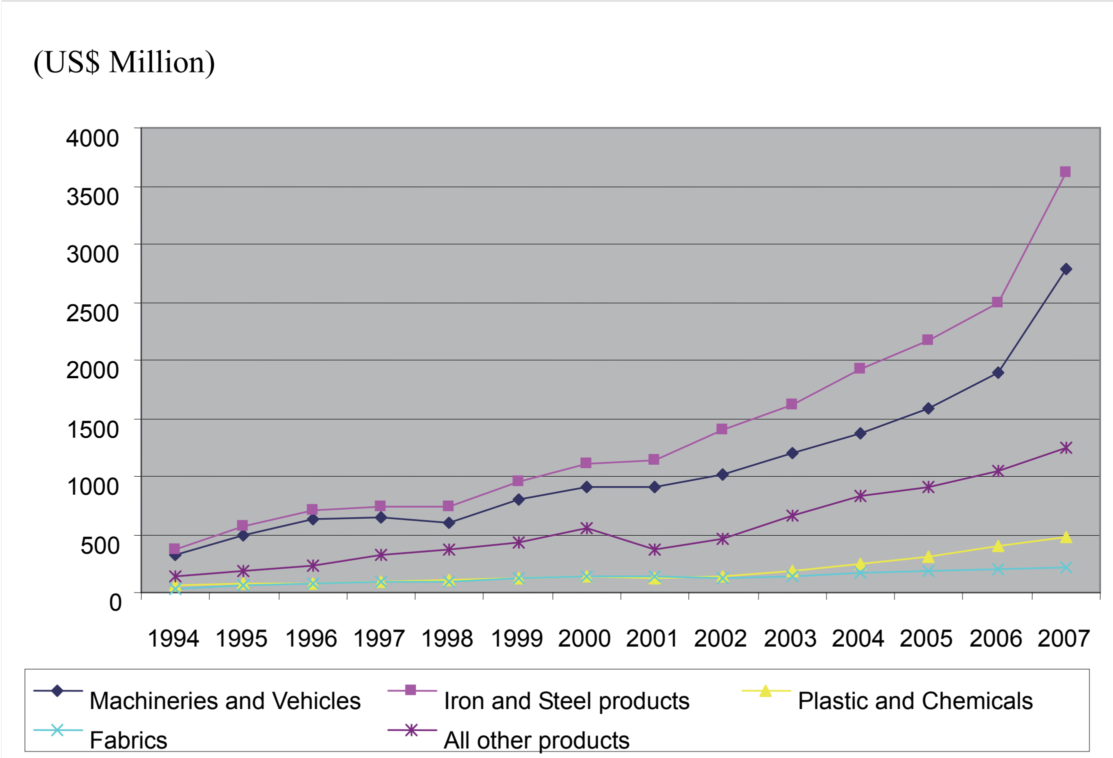


Note: *Fish and seafood include processed and prepared fish and meat.

Source: World Trade Atlas.

Japan exported mainly iron and steel products to Vietnam. As in the case of other CLMV countries, machinery and vehicles were also major export products to Vietnam. Japan's exports of iron, steel, machinery, and vehicle products gradually increased from 1994 to 2002 and then sharply increased up to 2007. Exports of fabrics, plastic, and chemical products also gradually increased, but still remained at a low level of less than US$ 500 million per year. The volume of other exported products also gradually increased.

Figure 17: Japan's Exports to Vietnam



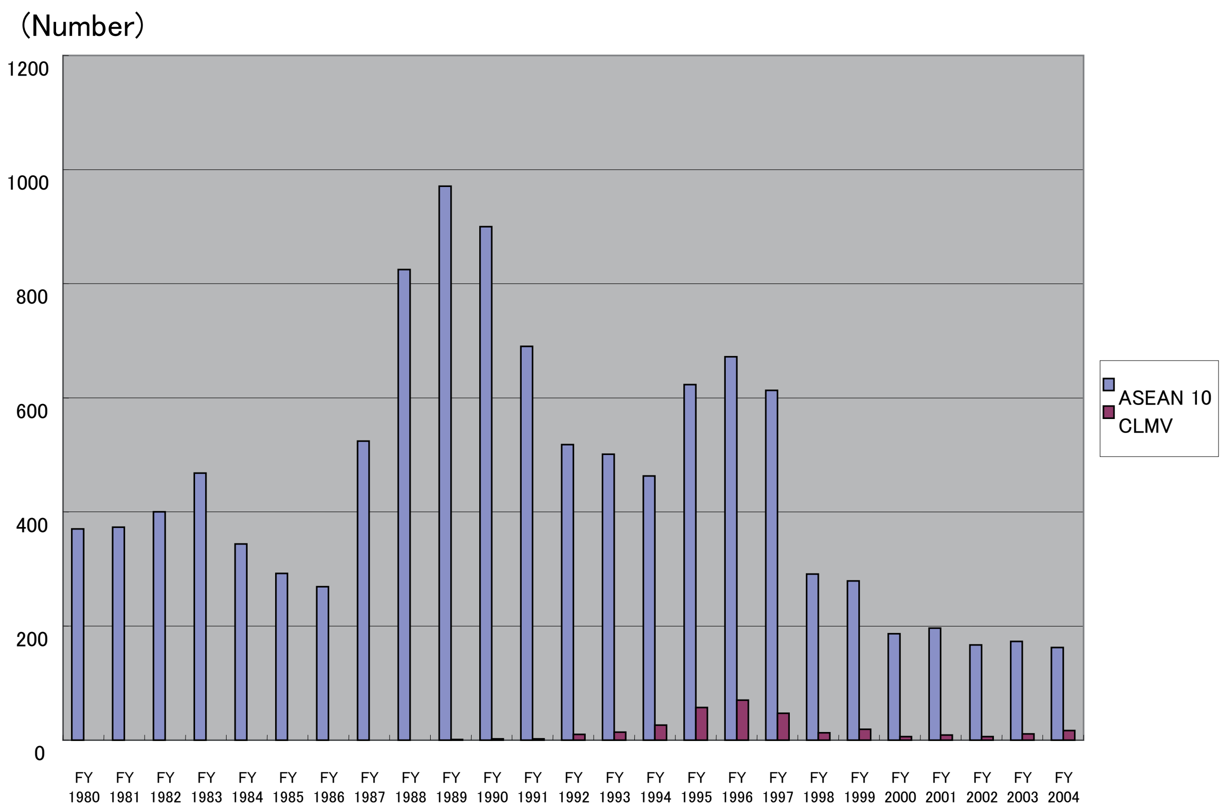
Source: World Trade Atlas.

All in all, Japan imported from CLMV not only natural resources but also labor-intensive, manufactured products such as clothes and footwear, the latter of which has a broader impact on CLMV's economic and industrial development in terms of employment and technology transfer. Japan is now heavily dependent on China's supplies of such daily products, but it can offer a huge domestic market of such items to CLMV producers as well. To open Japanese markets to CLMV products is critically important to enhance bilateral trade between Japan and CLMV in the future.

5.4 Japan's Investment in CLMV

While Japanese firms vigorously invested in the original ASEAN economies throughout the 1980s and the latter half of the 1980s in particular, they started investing in CLMV only in the 1990s and thereafter. According to the figures from Japan's Ministry of Finance, the first investment of a Japanese firm in Vietnam was recorded in 1989. After that, Japanese investments in CLMV gradually increased and reached a peak of 70 cases in 1996, accounting for approximately 10 percent of Japanese investments to the whole ASEAN. However, after the Asian Economic Crisis of 1997, Japanese investments in CLMV substantially declined as did those to the original ASEAN countries.

Figure 18: Japanese Foreign Investments in ASEAN and CLMV, Number



Source: Japanese Ministry of Finance

Among CLMV, Vietnam attracted the most Japanese investors since the mid-1990s and up to present while Cambodia, Laos, and Myanmar are not yet major host countries for Japanese investors. A detailed picture for CLMV follows:

5.4.1 Japanese Investment in Cambodia

Cambodia received FDI at a yearly average of US$ 225.7 million between 2000 and 2004. However, the FDI inflows to Cambodia suddenly increased, and it received US$ 1050.2 million in 2005 and US$ 4414.8 million in 2006. According to Dr. Chap's chapter in this volume, Cambodia received FDI equivalent to 4.7 percent of its GDP between 1998 and 2003, and this figure was the second highest among the ASEAN countries, coming behind Singapore with 5.9 percent. Cambodia has been attracting an increasing number of foreign investments recently.

However, Japan accounted for a negligible share (0.2 percent) of total FDI in Cambodia between 2000 and 2006. In contrast, China accounted for 36.6 percent, followed by Korea (32.0 percent), and the ASEAN (13.4 percent).

Table 10: Foreign Direct Investments in Cambodia, Approved Based, Share (%)

	2000	2001	2002	2003	2004	2005	2006
ASEAN	32.3%	47.5%	18.1%	23.9%	20.9%	19.4%	7.3%
China	17.7%	3.6%	16.7%	51.7%	57.0%	66.3%	30.7%
Hong Kong	3.0%	0.8%	1.1%	8.3%	0.0%	0.2%	0.2%
Taiwan	11.8%	40.8%	4.7%	2.0%	9.7%	1.5%	2.0%
Korea	12.1%	1.5%	54.6%	3.7%	3.5%	8.2%	43.3%
Japan	0.1%	0.0%	1.5%	0.0%	1.5%	0.0%	0.1%
American Continent	7.9%	4.2%	2.2%	0.0%	4.0%	1.4%	2.9%
European	13.7%	1.4%	1.1%	9.4%	3.5%	2.1%	13.5%
Others	1.3%	0.0%	0.0%	1.0%	0.0%	0.9%	0.0%
FDI Total (USD Million)	218.0	204.7	237.7	251.2	216.9	1050.2	4414.8

(Source) The Council for the Development of Cambodia.

Japanese investors are said to be more sensitive than other Asian countries' enterprises to good governance, policy consistency and predictability, and law enforcement. Lack of these factors hinder Japanese firms from investing in Cambodia. In order to improve investment climate in Cambodia, then Prime Minister Shinzo Abe and Cambodian Prime Minister Hun Sen, signed the "Agreement between Japan and the Kingdom of Cambodia for the Liberalization, Promotion, and Protection of Investment" on June 14, 2007 in Tokyo. Under this agreement, Japanese firms are entitled to be treated equally in terms of regulation and taxation as Cambodian firms when they invest in Cambodia. Moreover, Cambodia committed to combat an alleged corruption problem. Such efforts are expected to promote Japanese investments in Cambodia in the near future.

5.4.2 Japanese Investment in Laos

Laos received 919 foreign investment projects with a total amount of US$ 5,572.2 million from 2001 to March 2007. In terms of amount, Thailand was the top investor with US$ 1,334.1 million, occupying 23.9 percent of total foreign investments, followed by China with US$ 763.6 million (13.7 percent), Vietnam with US$ 463.4 million (8.3 percent), and France with US$ 419.1 million (7.5 percent). Thailand has long been a top investor in Laos due to geographical proximity, cultural and language similarities, and economic and industrial complementarities.

However, in terms of number of investments, China ranked 1st with 223 projects between 2001 and March 2007, followed by Thailand with 157 projects, and Vietnam with 157 projects. China has invested more rapidly in Laos in recent years. Thailand and China are currently the two major investors in Laos.

In contrast, Japanese investments in Laos have been slow. There were 29 Japanese investment projects with a total amount of US$ 418.4 million for the same period, accounting for only 3.2 percent in the number of projects and 7.5 percent in total amount approved. In order to promote Japanese investments in Laos, Japan and Laos signed the "Agreement between Japan and the Lao People's Democratic Republic for the Liberalization, Promotion, and Protection of Investment" on January 16, 2008 in Tokyo. As in the case of Cambodia, such efforts are expected to promote Japanese investments in Laos in the near future.

Table 11: FDI inflows to Laos, 2001 to March 2007

No	Country	Number	Amount (US$ Million)
1	Thailand	157	1,334.1
2	China	223	763.6
3	Vietnam	105	463.4
4	France	53	419.1
5	Japan	29	418.4
6	India	3	350.2
7	Australia	24	317.7
8	South Korea	99	274.2
9	Singapore	19	96.2
10	Malaysia	30	82.1
	Others	177	1,053.2
	Total	919	5,572.2

Management of Domestic and Foreign Investment (DDFI), Lao PDR.

5.4.3 Japanese Investment in Myanmar

In terms of ranking, Japan is not an important investor in Myanmar since its major foreign investment source countries are from the neighboring countries, including the ASEAN and China. According to data from the Ministry of National Planning and

Economic Development (MNPED) as of August 2007, Japan ranked 12th in foreign investments received by Myanmar, which represents only 1.5 percent share of Myanmar's total foreign investments. Japan's investment in Myanmar was significantly smaller than those of Hong Kong (ranked 5th), China (ranked 6th), and South Korea (ranked 9th).

Japanese investments were quite active in the first half of the 1990s. However, after the Asian Economic Crisis of 1997, they became dormant, and there were no new investments from Japan after 2005.

Up to August 2007, 22 Japanese investment projects were approved by the Myanmar Investment Commission (MIC). Of these, two projects terminated their operations, leaving 20 projects existing in Myanmar (Table 13). There are 11 Japanese investments in the manufacturing sector. Even though Japanese investments in Myanmar are rather small, Japan is one of the major investors in manufacturing. Japanese firms are more interested in the labor-intensive manufacturing sectors. However, unlike Chinese and Korean investors, they were not very successful in natural resources development, such as exploration and exploitation of natural gas and construction of hydropower plants. In reality, Myanmar's natural resources are a hot target of other Asian countries' investors including China, India, and Thailand.

Table 12: FDI inflows to Myanmar

(US$ Million)

No	Country	1989-1996	1997-2004	2005	2006	2007	Total
1	Thailand	1,027	314	6,034			7,376
2	U.K	1,332	148		273		1,753
3	Singapore	1,213	333		81		1,626
4	Malaysia	462	198				661
5	Hong Kong	403	101				504
6	China	29	165	1	281		475
7	France	470	0				470
8	U.S.A	244	0				244
9	Indonesia	211	31				241
10	South Korea	70	122		37	12	240
11	The Netherlands	238	1				239
12	Japan	167	45				212
13	Philippine	7	140				147
14	India	0	5	31	48		83
15	Australia	40	42				82
16	Austria	73	0				73
17	Canada	33	7				40
18	Russia	0	0		33		33
19	Panama	0	29				29
20	Germany	15	0				15
21	Denmark	13	0				13
22	Cyprus	0	5				5
23	Macau	2	2				4
24	Vietnam	0	4				4
25	Switzerland	0	3				3
26	Bangladesh	3	0				3
27	Israel	0	2				2
28	Brunei	0	2				2
29	Srilanka	1	0				1
	Total	6,052	1,699	6,066	753	12	14,581

(Note) 2007 includes figures from January to August.
(Sources) Myanmar Investment Commission (MIC).

Table 13: Japan's existing investments in Myanmar (as of August 2007)

(US $ Million)

No.	Business sector	No. of projects undertaken	Approved Amount
1	Fisheries	2	13.727
2	Manufacturing	11	44.383
3	Hotel and Tourism	3	68.000
4	Real Estate	1	31.313
5	Industrial Estate	1	12.000
6	Others	2	1.966
Total		20	171.389

Source: Ministry of National Economic Planning and Development

5.4.4 Japanese Investment in Vietnam

Japan is one of earliest and biggest foreign investors in Vietnam. The contribution of Japanese FDI in terms of percentage of disbursed and registered capital volume is higher than that of any other investor countries. Aside from this, there are many Japanese investors registered as originating from other third countries and territories. These investments were made by Japanese-affiliated firms in third countries.

Japanese FDI inflows to Vietnam started in 1989 through a project establishing the Mekong Auto Corp. Japanese investments increased considerably after 1994 when the U.S. embargo against Vietnam was lifted. The first Japanese FDI boom in Vietnam reached its peak in 1996 and then decreased until 1999. The lost growth momentum of Vietnam economy, the impact of Asian Economic Crisis of 1997, and

Table 14: FDI in Vietnam by Top Five Investor Countries, 1988 – March 2007

(US$ Million, Implemented Capital)

Ranking	Country/ Territory	Number of projects	Registered capital	Legal capital	Disbursed capital
1	Japan	903	8,772.1	3,754.7	5,202.9
2	Singapore	529	9,695.5	3,496.5	4,068.7
3	Taiwan	1,739	9,655.5	4,242.9	3,172.6
4	Republic of Korea	1,655	n.a.	4,594.9	2,946.3
5	Hong Kong	432	5,685.3	2,095.5	2,326.1

Source: Department of Foreign Investment, Ministry of Planning and Investment, Vietnam.

Japanese firms' discontent with Vietnam's investment climate have been claimed as the causes of this decline.

Japanese FDI inflows again increased starting 2000. Then Vietnam Prime Minister Phan Van Khai and former Japan Prime Minister Koizumi signed the "Japan-Vietnam Joint Initiative to Improve the Business Environment with a View to Strengthening Vietnam's Competitiveness" in April 2003. Eventually, the "Agreement between Japan and the Socialist Republic of Vietnam for the Liberalization, Promotion, and Protection of Investment" was signed in November 2003. The former contributed to betterment of the investment climate in Vietnam, and the latter gave more confidence Japanese investors in Vietnam's investment environment. Thus, Japanese FDI inflows have considerably accelerated. The investment promotion and protection agreement between Japan and Vietnam was the first one Japan signed with the CLMV countries. As previously mentioned, Cambodia and Laos followed Vietnam's initiative afterwards.

Table 15 : Japanese FDI in Vietnam, 1988 – Oct. 2007

Year	Number of projects		Amount of capital (in mill US dollars)	
	Cumulative	New	Cumulative	New
1988-93	50	--	378.4	--
1994	76	26	679.0	300.6
1995	n.a.	n.a.	1130.0	451.0
1996	177	n.a.	2400.1	1270.1
1997	236	59	3037.5	637.4
1998	256	20	3299.1	261.6
1999	270	14	3360.6	61.5
2000	296	26	3441.2	80.6
2001	336	40	3604.2	163.0
2002	385	49	3706.8	102.6
2003	493	108	4032.5	325.7
2004	551	58	6211.4	2178.9
2005	684	133	6907.2	695.8
2006	838	154	8397.6	1490.4
2007	903	65	8772.1	374.5

Source: Ministry of Planning and Investment and General Statistic Office of Vietnam.

Vietnam ranked 8th on the list of top destinations for Japanese investments in 2000. It jumped to 4th rank in 2005 after China, India, and Thailand. Japanese FDI projects in Vietnam are mostly motivated by market-seeking and efficiency-seeking incentives.

Japanese enterprises usually take into account such factors as Vietnam's economic growth rate, availability of skilled labor, and industrial clusters, when they decide to invest. Vietnam's political, social, and exchange rate stabilities also attract Japanese investors. Vietnam has become a popular investment destination for Japanese firms seeking to reduce their excessive dependence on China (i.e., China+1 strategy).

Nevertheless, the lack of skilled workers, middle-level managers, and engineers (especially mechanical and electronic engineers) in Vietnam do not satisfy Japanese investors. Moreover, there is a shortage of Japanese-speaking staff in Vietnam.

Japanese FDI projects are mostly located in the northern and southern pivotal economic regions of Vietnam. A large number of Japanese FDI projects are in manufacturing concerns. There are also quite a number of projects in the service sectors, including construction, logistics, hotels and restaurants, but few in agriculture, aquaculture, and the mining industry. Recently, there has been a surge of Japanese investments in Vietnam's electronics and telecommunications industries.

Japanese manufacturing FDI enterprises tend to commit high localization. Many commitments, however, could not be realized due to the underdevelopment of Vietnam's supporting industries. Regarding technology transfer, almost all Japanese manufacturing and construction enterprises have transferred assembly, operating, maintenance and quality control technology to Vietnam. However, they failed to transfer more advanced and complex technologies to local business partners and workers in Vietnam. Technology diffusion from Japanese companies to Vietnamese firms has generally been rather slow.

Many Japanese firms are interested in investing in CLMV. However, most of them are still in the stage of gathering information, planning and doing feasibility studies, except the case of Vietnam where Japanese firms are already vigorously doing business. On the other hand, CLMV governments are also trying to attract and promote Japanese investments in their countries by, for example, signing investment promotion and protection agreements with the Japanese government. More and more Japanese investments will be coming to CLMV countries in the near future, and they are expected to contribute to the host countries' economic and industrial development in the long run.

6. CONCLUDING REMARKS

Japan has played an important role in economic cooperation with CLMV. The present approach of Japanese economic cooperation is on a country-by-country basis. In contrast, the New Concept of Mekong Region Development is a new attempt based on regionwide development. This development concept appeared in Japan's ODA Charter, which was revised in 2003. Japan will continue to develop economic and social infrastructure that are in great demand in CLMV countries and provide assistance to promote sustained growth according to the New Concept.

While Japan, along with Thailand, is a top donor in CLMV, Japan's regionwide development strategy and plan for these areas are not yet clear. To implement regionwide development efficiently and effectively, it is essential to pursue studies related to regional public goods provided by regionwide development. In this sense, the Mekong Region Development Scheme provides an important opportunity for China, Japan, and Korea to cooperate. Through the cooperation process of these three countries and the ASEAN, East Asia's sustainable growth will be ensured.

Another challenge for Japan is to promote its trade and investment with CLMV countries. Japan's trade and investment relations with CLMV have been relatively weak.

However, Japan recently increased its imports from CLMV and showed an increasing interest in investing in those countries. Japan has been importing from CLMV not only natural resources but also labor-intensive products such as clothes and footwear, the latter of which is said to have a broader impact on exporting economies in terms of employment creation and technology transfer. Japan is currently heavily dependent on China's supplies of such items and has been trying to diversify its procurement source countries. Accordingly, Japan can offer its markets to CLMV, and this will significantly contribute to CLMV's economic and industrial development in the long run. Japanese investments in CLMV will also contribute to export promotion of their products in Japan. Both the Japanese and CLMV governments are exerting effort to promote foreign investments by, for example, signing investment promotion and protection agreements between them. Such efforts to promote trade and investment between Japan and CLMV will bear their fruits in the near future.

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Chapter 8

KOREA'S ECONOMIC RELATIONS WITH CLMV COUNTRIES

Jaewan Cheong

ABSTRACT

Korea's diplomatic relations with Cambodia, Laos, Myanmar, and Vietnam (CLMV) started to normalize in the 1990s. From then on, the CLMV countries have risen to become Korea's principal target in external trade and overseas direct investment (ODI). Especially in ODI, tourism, and official development assistance (ODA), the CLMV countries have been rapidly rising as preferred destinations of Korea. Vietnam, in particular, has become one of Korea's major destinations of ODI after the two started forming friendly relations in 1992. The economic cooperation between the two areas has indeed been showing signs of expansion and this is envisaged to continue as long as the economic growth of Korea and CLMV countries continues. For Korea, this can be made possible through the expansion of ODA support and continued application of the Generalized System of Preference to less developed countries, as well as the improvement of its trade imbalance. For CLMV countries, required action points include the development of human resources, improvement of foreign investment environment, systematization and development of aid management organizations, restructuring of state-owned enterprises, promotion of private sector participation, and development of the financial and capital markets. Clearly, the challenge to sustain economic growth is more daunting for CLMV countries given their lower state of economic development. Strengthening the economic cooperation between Korea and CLMV countries could help the latter address this challenge.

1. INTRODUCTION

Cambodia, Laos, Myanmar, and Vietnam—known collectively as CLMV—are rapidly getting the attention of many as the newly rising economic circle in Asia due to their investment advantages (e.g., abundant natural resources, and inexpensive labor power). Their pursuit of economic reforms to achieve progress and development by embracing an open door policy as manifested in their joining the World Trade Organization (WTO) recently has added more to their growing popularity in the region. Cambodia and Vietnam joined the WTO successively (in 2004 and 2007, respectively) while Laos is seeking admission. (On the other hand, Myanmar was a GATT member and a member of the WTO since the latter came into being in 1995) Accordingly, the economic system of these countries is changing rapidly, including their foreign trade and investment environment.

Necessary for the steady development of the ASEAN+3 and the formation of an economic community in East Asia is the dissolution of development gaps within the region, which continue to rise. These development gaps between the more advanced developing countries and the least developed ones as represented by the CLMV countries are at a serious level. The expansion of these gaps has grave consequences on the process of economic integration in East Asia.

Simultaneous with the rising economic importance of the CLMV countries is the rapidly increasing economic cooperation between Korea and the CLMV countries. This is manifested not only in trade and overseas direct investment (ODI) but also in the cooperation between and among their governments. Especially in ODI, tourism, and official development assistance (ODA), the CLMV area is rapidly rising as a newly emerging market.

This research focuses on the economic cooperation between Korea and the CLMV countries over the years. It analyzes the scope of this cooperation and suggests policies for its expansion. The first section examines the international trade policies of Korea and strategies concerning CLMV countries. Then, the trade and investment of Korea to CMLV countries through the private sector is analyzed in a second section. The next section examines the economic cooperation between Korea and the CLMV countries at the government level. It discusses the ODA policy of Korea, which became official in the 1980s through the establishment of the Economic Development Cooperation Fund and later on, the grant-type ODA. The fourth section makes an evaluation of the economic cooperation relationship between Korea and the CLMV countries. The final section provides some policy recommendations that are necessary for expanding such cooperation.

2. KOREAN INTERNATIONAL TRADE POLICIES AND STRATEGIES CONCERNING CLMV COUNTRIES

During the 1950s, there was no significant international trade policy in Korea as the country was heavily dependent on foreign aids. Significant transformations came, however, beginning the 1960s, when the economic development path of Korea has centered on international trade, especially exports. From 1964, when exports totaled almost USD100 million, and up to the present, Korea's export growth rate was as high as over 20 percent in yearly average. Accordingly, Korea has found its place among the 12 largest exporting countries. Export has especially played a critical role in its economic growth and job creation. The international trade policies of the Korean government have accounted for this highly recognized success along with many other factors, such as its strong emphasis on training and education toward a well-trained labor force. Moreover, it was in the 1960s when the foundation for the many trade policies in Korea such as import and export measures, and trade diplomacy, among others, were established. In particular, during this period, the economic growth strategy shifted from the import-substitution type to the export-orientation type.

In the 1970s, the export promotion policies that were started in the previous decade were continued and intensified, and other policies that encouraged exports were implemented. Then, in the 1980s, the ballooning trade surplus and increasing trade pressures triggered the government to adopt a trade liberalization policy. While import liberalization areas were widened, advancement and globalization of trade management system were carried out.

In the 1990s, in addition to the trade sector, Korea opened its political, economic, cultural, and social sectors. Upon closing of the Uruguay Round in 1993 and its accession to the Organization for Economic Co-operation and Development, otherwise known as OECD, an omni-directional opening of the country proceeded. Korea even extended trade diplomacy with northern countries, then Communist ones. Korea formed diplomatic relations with Vietnam in 1992, with Laos in 1995, and with Cambodia in 1997. Then, beginning year 2000, the Korean government pursued simultaneous multilateral free trade agreements (FTAs) with these countries and provided support to companies to move toward globalization. In the same year, the Generalized System of Preferences (GSP) has been introduced as a means to support the industrialization and economic development of developing countries. Among the CLMV countries, Cambodia, Laos, and Myanmar are receiving GSP from Korea.[1]

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[1] GSP refers to the preferential system of tariff by developed countries in which a tariff rate lower than the regular rate (in other words, the most favored nation [MFN] tariff rate) or no tariff is imposed on goods imported from developing countries or those that are especially classified as least

Meanwhile, Korea's ODI has seen its active start from the late 1980s when international trade surplus began to accumulate. Previously, the overseas investment policy was limited to secondary measures for boosting exports or developing resources that the country did not produce.

Up to 1979, Korea's overseas investment policy was a policy-initiating process and then it became a policy-adjusting process from 1980 to 1985. From 1986, the Korean government started to deregulate ODI as the won (Korean currency) appreciated, domestic wage increased, and aggravating trade conflicts from international trade surplus came to surface. In particular, the government adopted the Negative List System in ODI. From 1991 to the onset of the East Asian crisis, the Korean government encouraged ODI not only in the aspect of management of international trade balance but also in the aspect of industrial policy. Because of these changes in policy, the relocation of labor-intensive industries was accelerated. Around that time, the Indochina region was opened to outsiders and it therefore emerged as Korea's new investment destination. Since 1999, the private sector has been the leading source of ODI as procedures, regulations, and preconditions related to the overseas investments have been relaxed. The government has also been very active in providing ODI since 2005.

Thus, it was during the late 1980s when Korea pursued external economic expansion in terms of broadening its international trade policy, which was also the same time when the CLMV countries started to open their market. When CLMV countries tried to transform into a market-oriented economy and sought for economic reforms, Korea restored its diplomatic relations with these countries. Since then, trade and investment between these two regions has considerably increased.

3. ECONOMIC COOPERATION WITH CLMV COUNTRIES: PRIVATE SECTOR

3.1 Trade sector

Trade between Korea and CLMV countries started to grow when the Indochina region opened its door to outsiders and restored its diplomatic relations with Korea. Before that,

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developed countries in order to promote export expansion and industrialization in these countries. GSP plays a key role in supporting the "industrialization through export" strategy of developing countries. Korea is currently applying GSP in 49 least developed countries including 13 countries in Asia, 34 countries in Africa, 1 country in the American continent, and 1 country in the Middle East.

only Myanmar had trade relations with Korea, albeit somehow insignificant. Particularly due to the restoration of diplomatic relations and the effects of the *Doi Moi* reforms that invigorated the Vietnamese market and made it the newly emerging market in the region, the trade between Korea and Vietnam has shown a rapid growth. Over the years, the trade between these two countries has risen steadily although it fell in the narrow range right after the East Asian crisis. Trade volume amounted to USD 1,998 million in 1996 right before the East Asian crisis and totaled USD5,320 million as of 2006. Nevertheless, the CLMV region takes up only 0.84 percent of Korea's total foreign trade since its total trade has grown rapidly and its trade size with China, Japan, and the US has expanded.

While Korea's trade with Myanmar has continued, the other countries were out of the picture for a while when the communist regimes took charge in the Indochina region.

Table 1: Korea's trade with CLMV by year (1996~2006)

(US$ in million, %)

		1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Cambodia	Volume	0	54	63	85	98	109	118	110	133	150	210
	Growth Rate			16.7	34.9	15.3	11.2	8.3	-6.8	20.9	12.8	40.0
Laos	Volume	10	9	5	12	5	6	4	8	10	16	41
	Growth Rate		-10.0	-44.4	140.0	-58.3	20.0	-33.3	100.0	25.0	60.0	156.3
Myanmar	Volume	148	154	161	203	312	283	199	213	192	176	217
	Growth Rate	48.0	4.1	4.5	26.1	53.7	-9.3	-29.7	7.0	-9.9	-8.3	23.3
Vietnam	Volume	1,831	1,842	1,545	1,709	2,008	2,118	2,710	3,072	3,929	4,126	4,852
	Growth Rate	18.5	0.6	-16.1	10.6	17.5	5.5	28.0	13.4	27.9	5.0	17.6
CLMV	**Volume**	**1,989**	**2,059**	**1,774**	**2,009**	**2,423**	**2,516**	**3,031**	**3,403**	**4,264**	**4,468**	**5,320**
	Growth Rate	**20.9**	**3.5**	**-13.8**	**13.2**	**20.6**	**3.8**	**20.5**	**12.3**	**25.3**	**4.8**	**19.1**
CLMV/World		**0.71**	**0.73**	**0.79**	**0.76**	**0.73**	**0.86**	**0.96**	**0.91**	**0.89**	**0.82**	**0.84**
ASEAN/World		11.56	11.72	10.84	11.37	11.51	11.10	11.18	10.39	9.70	9.80	9.74

Source: Korea International Trade Association (KITA).

Table 2: Korea's exports to and imports from CLMV by country and year (1995~2006)

(US$ in million)

	Cambodia		Laos		Myanmar		Vietnam	
	Export	Import	Export	Import	Export	Import	Export	Import
1995					87	13	1,351	194
1996			8	2	130	18	1,599	232
1997	52	2	7	2	137	17	1,603	239
1998	62	1	5	0	148	13	1,361	184
1999	80	5	10	2	187	16	1,445	264
2000	96	2	4	1	289	23	1,686	322
2001	102	7	6	0	232	51	1,732	386
2002	115	3	4	0	143	56	2,240	470
2003	106	4	8	0	184	29	2,561	511
2004	126	7	9	1	162	30	3,256	673
2005	144	6	14	2	120	56	3,432	694
2006	205	5	23	18	121	96	3,927	925

Source: Korea International Trade Association (KITA).

Trade between Korea and the other countries was reactivated only after the Indochina region opened its door and started to convert to the market economic system.

Trade with Cambodia started in 1997 when the two countries restored their diplomatic relation. If the volume of trade was only USD 54 million in 1997, this has increased almost four times to USD 210 million by 2006. Korea has maintained trade surplus with Cambodia, which continues to rise.

Korea and Laos reestablished their diplomatic relation in 1995 and started trading the following year. While there has been trade between the two countries before, the volume was very small. However, from USD 10 million in 1996, this has increased to USD 41 million by 2006. Korea’s trade surplus with Laos has been steadily expanding.

Trade between Korea and Myanmar has been ongoing since the 1960s but in small quantity. Things changed in the 1990s when the two countries began to trade actively. The trade volume, which was USD 100 million in 1995, reached an all-time high of USD 312 million in 2000. As of 2006, it was estimated at USD 217 million. Korea has been maintaining trade surplus with Myanmar as well.

Table 3: Korea's exports to CLMV countries by commodity (2006)

(US$ in thousand)

Cambodia			Laos		
MTI code	Commodity	Value	MTI Code	Commodity	Value
	Total Sum	205,093		Total Sum	23,328
43	Fabrics	82,122	74	transporter	18,928
44	made-up textiles	39,437	81	industrial electronic articles	693
74	Transporter	36,185	84	heavy electric equipment	575
81	industrial electronic articles	6,696	32	articles of rubber	435
62	nonferrous metal products	6,499	61	articles of iron or steel	396
72	special machine	6,498	22	precision chemistry	309
22	precision chemistry	4,694	71	general machine	308
33	articles of leather or fur	2,306	1	agricultural products/farm produce	247
71	general machine	2,123	83	electronic components	245
42	Yarn	1,906	43	fabrics	240
Myanmar			**Vietnam**		
MTI code	Commodity	Value	MTI Code	Commodity	Value
	Total Sum	121,311		Total Sum	3,927,476
43	Fabrics	18,945	43	fabrics	639,949
72	special machine	17,537	13	mineral fuels	524,815
21	Petrochemicals	13,918	61	articles of iron or steel	350,409
61	articles of iron or steel	9,226	21	petrochemicals	324,510
31	articles of plastic rubber or leather	9,084	81	industrial electronic articles	314,941
44	made-up textiles	8,688	72	special machine	214,371
33	articles of leather or fur	7,455	62	nonferrous metal products	212,512
22	precision chemistry	7,345	74	transporter	169,795
25	materials of paper or articles of paper	4,313	22	precision chemistry	167,202
51	miscellaneous goods/sundries	3,323	44	made-up textiles	123,417

Source: Korea International Trade Association (KITA).

Korea has been trading with Vietnam since the 1980s although the volume was small. Changes occurred, however, in 1986 when Vietnam took the road to reform and opened its market. In 1992, the diplomatic relation between the two countries was revived and since then, significant improvements in trade were seen. In 1991, trade volume amounted to USD 240 million but this has increased almost 20 times to USD 4,852 million as of 2006. Same with the others, Korea has been maintaining trade

Table 4: Korea's imports to CLMV countries by commodity (2006)

(US$ in thousand)

Cambodia			Laos		
MTI code	Commodity	Value	MTI code	Commodity	Value
	Total Sum	5,461		Total Sum	17,760
44	made-up textiles	3,549	62	nonferrous metal products	14,211
74	Transporter	853	51	miscellaneous goods/sundries	1,578
62	nonferrous metal products	430	1	agricultural products/farm produce	1,125
3	forest products	204	3	forest products	615
51	miscellaneous goods/sundries	97	44	made-up textiles	231
1	agricultural products/farm produce	71			
33	articles of leather or fur	69			
63	table wares	61			
81	industrial electronic articles	43			
4	fishery products	13			
Myanmar			**Vietnam**		
MTI Code	Commodity	Value	MTI Code	Commodity	Value
	Total Sum	96,433		Total Sum	924,856
13	mineral fuels	50,738	4	fishery products	206,482
44	made-up textiles	18,411	44	made-up textiles	88,161
3	forest products	15,455	1	agricultural products/farm produce	87,479
1	agricultural products/farm produce	5,140	42	Yarn	84,689
4	fishery products	4,715	51	miscellaneous goods/sundries	83,406
51	miscellaneous goods/sundries	724	3	forest products	71,455
59	other livingware	223	52	Furniture	54,608
52	Furniture	172	13	mineral fuels	46,511
74	Transporter	160	84	heavy electric equipment	23,895
72	special machine	138	43	Fabrics	19,154

Source: Korea International Trade Association (KITA).

surplus with Vietnam, which amounted to USD 3 billion in 2006. This can be attributed to the rapidly increasing ODI from Korea to Vietnam.

Korea's export items to CLMV countries (MTI, 2 units) follow a similar pattern for each country. In general, the foremost item is fabrics followed by mineral fuels, articles of iron or steel, industrial electronic articles, special machine, and transporter. Only in Laos is transporter the number one item.

In contrast with its export pattern, Korea's import pattern varies with each country. Made-up textiles take up over 60 percent of Korea's import from Cambodia, followed by transporter. Most of its import from Laos, meanwhile, is nonferrous metal products. Mineral fuels take up half of its total import from Myanmar, followed by fabrics and forest products. Fishery products including shrimp are Korea's foremost import item from Vietnam, followed by fabrics, agricultural products/farm produce, yarn, and miscellaneous goods/sundries.

3.2 Overseas Direct Investment (ODI)

3.2.1 Overall feature

Korea's ODI has been active since the late 1980s. In that period, most investments went to Southeast Asia, including Indonesia, but scarcely reached the CLMV countries. Investment to CLMV countries commenced in the early part of 1990s when the region began to pursue reformation and converted to a market economy. It was also during this period when CMLV restored their diplomatic relations with Korea. Investments increased drastically in the early 1990s but fell during the East Asian crisis and again rose from 2000. Especially in 2005 and 2006, Korea's ODI to CLMV countries registered a groundbreaking increase, taking up 5.5 percent and 10.5 percent, respectively, of the total (in terms of investment approval). Meanwhile, the actually implemented amount is lower than the numbers and appears to be around 44 percent.

In terms of ODI of CLMV countries to Korea, it is noticeable that the investment of early-stage developing countries is still small. As of the end of 2006, their ODI to Korea is only USD 3.2 million from 41 projects, with Vietnam contributing the biggest part.

Table 5: Korea's ODI to CLMV countries by year (1980~2006)

(Number, US$ in million, %)

Year	Acceptance				Investment		
	No. of projects	Amounts	ASEAN/ World	CLMV/ World	Amounts	ASEAN/ World	CLMV/ World
1980	2	0.02	29.0	0.0	0.02	30.7	0.0
1981	0	0	11.4	0.0	0	14.1	0.0
1982	0	0	0.7	0.0	0	5.8	0.0
1983	0	0	32.8	0.0	0	25.1	0.0
1984	0	0	1.0	0.0	0	18.9	0.0
1985	0	0	2.3	0.0	0	14.3	0.0
1986	0	0	0.3	0.0	0	0.8	0.0
1987	0	0	45.1	0.0	0	31.2	0.0
1988	0	0	73.8	0.0	0	14.8	0.0
1989	0	0	21.6	0.0	0	16.1	0.0
1990	3	58.7	30.4	2.6	9.5	25.0	1.0
1991	2	64.0	22.4	3.6	5.2	29.6	0.5
1992	21	103.5	13.4	5.1	22.4	22.3	1.8
1993	42	118.1	12.6	5.9	29.5	13.3	2.3
1994	60	186.0	15.4	5.1	92.7	11.2	4.0
1995	53	228.0	15.0	4.4	185.5	19.7	6.0
1996	57	247.4	11.5	3.5	109.4	10.3	2.5
1997	54	239.5	17.8	3.9	175.7	16.8	4.7
1998	17	116.2	12.6	2.0	93.9	10.6	2.0
1999	30	78.8	9.2	1.5	53.8	13.9	1.6
2000	48	129.4	11.4	2.1	82.2	9.3	1.6
2001	70	110.0	7.8	1.7	64.0	7.5	1.2
2002	129	395.1	10.3	6.3	150.5	9.5	4.1
2003	113	730.1	22.3	13.1	166.8	13.4	4.1
2004	137	367.9	9.0	4.7	194.6	8.6	3.2
2005	216	494.6	10.3	5.5	336.3	9.9	5.1
2006	348	1,937.2	20.0	10.5	711.7	12.6	6.6
Cumulative	**1,402**	**5,604.5**	**15.3**	**5.3**	**2,483.7**	**12.3**	**3.6**

Source: The Export-Import Bank of Korea.

Table 6: Investment of CLMV and ASEAN to Korea by country (~2006)

		No. of Projects	Amounts(US$ in thousand)
Singapore		480	2,188,993
Malaysia		482	3,261,036
Indonesia		39	109,494
Thailand		62	9,314
Brunei		7	1,268
Philippines		52	120,284
CLMV	Cambodia	2	98
	Laos	1	202
	Myanmar	15	730
	Vietnam	23	2,173
	Sub-total	41	3,203
ASEAN Total		**1,158**	**5,693,594**

Source: Ministry of Commerce, Industry and Energy of Korea.

3.2.2 Korea's ODI to Cambodia

Korea’s ODI to Cambodia intensified when their diplomatic relation was restored but it went down during the East Asian crisis. However, it began to recover beginning in 1999. The volume amounted to over USD 109 million and 173 million, respectively, in 2005 and 2006. The actually implemented investment reached USD 209.26 million for 151 projects with an implementation rate of 57 percent.

By industry, manufacturing, which includes fabrics and sewing, takes up 28 percent of the ODI. Recently, it is expanding to the sectors of construction, real estate, and services. Investment on the financial sector, however, has yet to be seen.

Table 7: Korea's ODI to Cambodia by year (1992~2006)

(numbers, US$ in thousand)

Year	Acceptance		Investment	
	No. of Projects	Amounts	No. of Projects	Amounts
1992	1	1,919	1	1,300
1993	0	0	0	319
1994	1	2,300	1	900
1995	1	500	1	258
1996	10	10,157	6	3,798
1997	14	18,067	10	5,845
1998	5	2,176	4	898
1999	7	8,850	8	6,475
2000	6	9,276	6	3,516
2001	7	8,267	5	5,540
2002	9	8,510	9	4,107
2003	9	3,987	9	9,670
2004	9	7,657	8	13,653
2005	35	109,290	31	30,859
2006	51	173,565	52	122,125
Cumulative	165	364,521	151	209,263

Source: The Export-Import Bank of Korea.

According to statistics of the Cambodian government (on approval basis), Korea’s investment to Cambodia amounted to USD 257 million from 2000 to 2006, making Korea the third largest investor in Cambodia, next to China and Russia, in terms of total foreign direct investment. Korea’s investment to Cambodia peaked in 2002, 2005, and 2006.

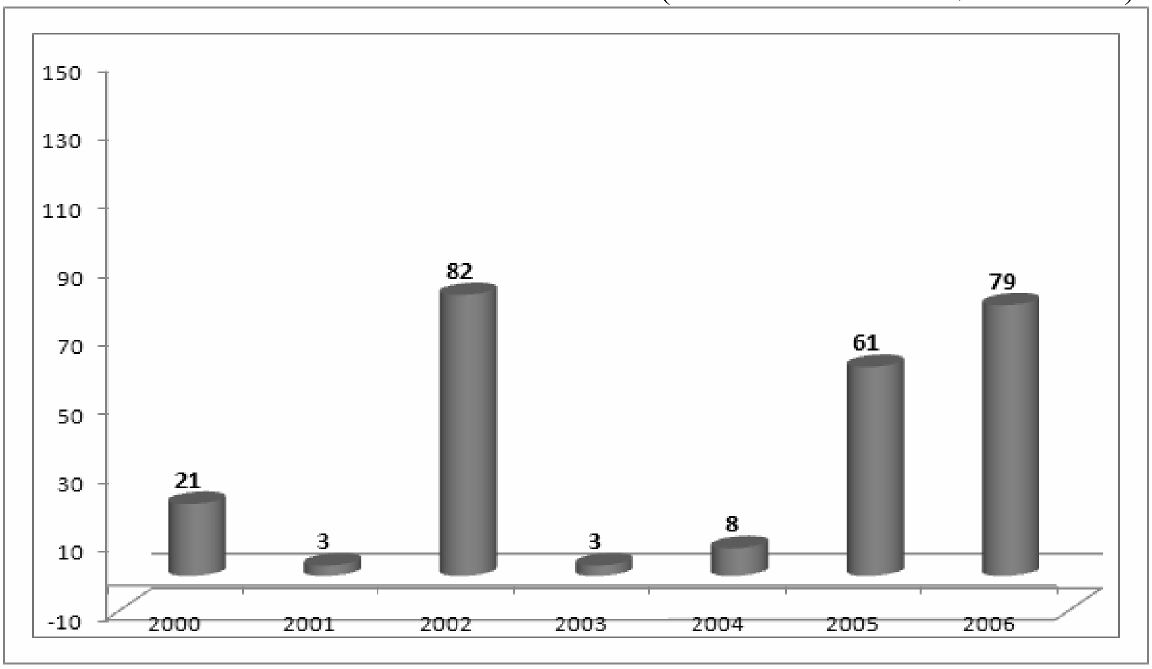
Table 8: Korean investment to Cambodia by sector (cumulative figure to 2006)

Sector	Acceptance		Investment	
	No. of Projects	Amount (US$ in thousand)	No. of Projects	Amount (US$ in thousand)
Agriculture & Fishery	4	3,120	3	380
Mining	3	15,136	3	18,503
Manufacturing	57	101,892	50	58,518
Construction	25	86,422	24	27,350
Whole Sale & Retail	20	23,231	18	9,162
Transport & Storage	5	4,892	4	4,145
Telecommunications	3	9,349	3	8,050
Lodging & Restaurants	8	3,301	8	2,616
Service	31	47,483	30	21,736
Real Estate	9	69,695	8	58,803
Cumulative	**165**	**364,521**	**151**	**209,263**

Source: The Export-Import Bank of Korea.

Figure 1: Korea's investment approvals by Cambodian government

(Total fixed assets: US$ in thousand)



Source: International Monetary Fund (August 2007).

3.2.3 Korea's ODI to Lao PDR

Korea's investment to Laos started in 1994, a year before their diplomatic relation was restored. ODI to Laos peaked in 1996 and 1997, but declined after the East Asian crisis. It was reactivated beginning 2006. Total accumulated amount (on approval basis) stood at USD 93.16 million for 31 projects as of 2006.

According to statistics of the Export-Import Bank of Korea, Korea's investment to Laos is concentrated on a specific area, which is construction. Investment in the construction industry takes up 84 percent of the total ODI. Manufacturing and service industry received only a small portion of the investment.

Table 9: Korea's ODI to Lao PDR by year (1992~2006)

Year	Acceptance		Investment	
	No. of Projects	Amounts (US$ in thousand)	No. of Projects	Amounts (US$ in thousand)
1992	1	300	1	300
1993	0	200	0	200
1994	4	2,890	4	818
1995	1	9,900	1	949
1996	2	31,125	1	964
1997	1	27,540	2	25,516
1998	2	5,300	1	5,864
1999	1	700	1	2,274
2000	1	3,000	1	5
2001	0	0	0	35
2002	2	1,300	1	50
2003	2	1,221	1	746
2004	2	1,955	3	2,090
2005	0	0	0	0
2006	12	7,694	12	2,815
Cumulative	31	93,125	29	42,626

Source: The Export-Import Bank of Korea.

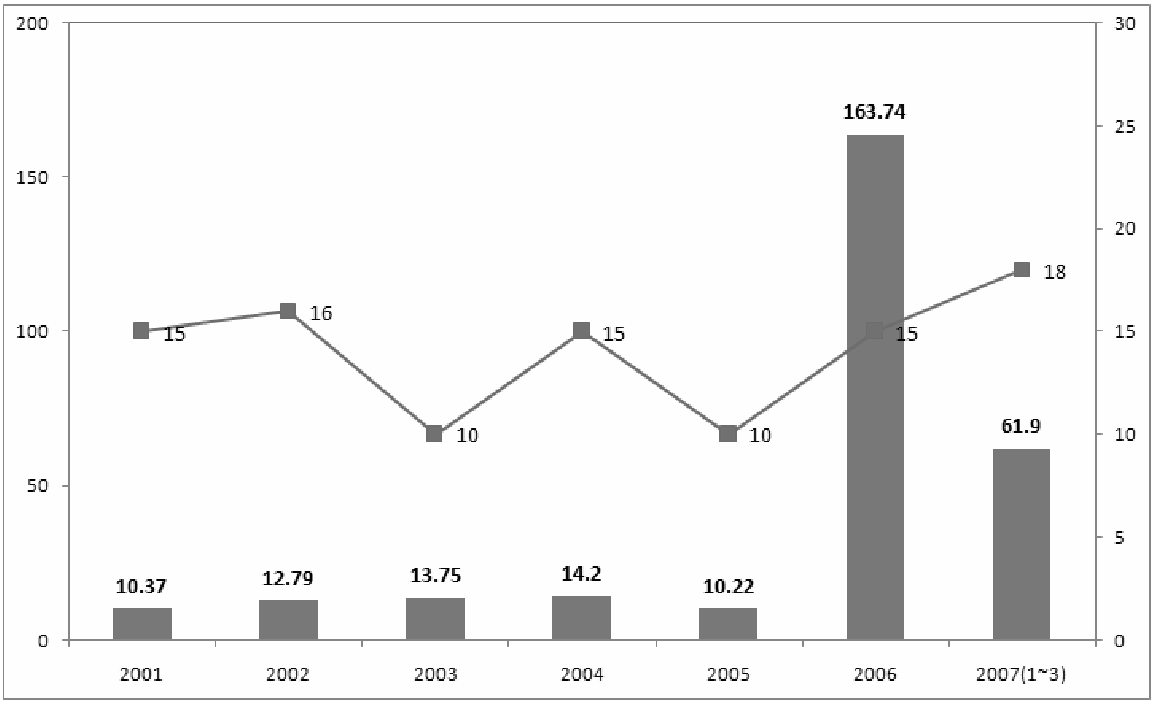
Table 10: Korea's ODI to Lao PDR by sector (cumulative figure)

Sector	Acceptance		Investment	
	No. of Projects	Amounts (US$ in thousand)	No. of Projects	Amounts (US$ in thousand)
Agriculture & Fishery	1	980	1	201
Mining	1	2,500	1	1,087
Manufacturing	7	3,524	7	2,536
Construction	6	77,990	6	34,173
Whole Sale & Retail	7	2,360	7	843
Transport & Storage	1	130	0	0
Lodging & Restaurants	2	2,400	2	1,900
Service	6	3,241	5	1,886
Total	**31**	**93,125**	**29**	**42,626**

Source: The Export-Import Bank of Korea.

Figure 2: Korea's investment approvals by Lao government

(Numbers, US$ in million)



Source: Lao Government.

Moreover, based on statistics, Korea’s investment to Laos (on the approval basis) has amounted to USD 274.19 million for a total 99 projects from 2000 to March 2007, and has posted a rapid growth in 2006 and 2007. As of March 2007, Korea ranked eighth in total FDI in Laos. It invested heavily on the development of Laos’ waterpower resources.

Table 11: Korea's ODI to Myanmar by year (1990~2006)

Year	Acceptance		Investment	
	No. of Projects	Amounts (US$ in thousand)	No. of Projects	Amounts (US$ in thousand)
1990	3	58,700	2	9,450
1991	2	64,034	1	5,188
1992	1	170	1	4,034
1993	2	2,000	2	984
1994	6	1,965	3	399
1995	5	1,490	5	1,410
1996	6	5,344	6	3,302
1997	10	13,165	8	5,481
1998	1	3,768	1	6,106
1999	4	5,485	2	4,843
2000	11	20,473	10	8,699
2001	8	3,178	6	2,948
2002	1	2,401	1	660
2003	1	2,602	1	496
2004	0	455	0	0
2005	0	830	0	969
2006	2	470	2	465
Cumulative	63	186,530	51	55,434

Source: The Export-Import Bank of Korea.

3.2.4 Korea's ODI to Myanmar

Korea and Myanmar has maintained diplomatic relation since 1975. Korea's ODI to Myanmar peaked in 1990 and 1991 but grew inconsistently since then. The decline has been drastic from 2001. This decline has been attributed to a number of factors, particularly to the embargo on Myanmar imposed by the international community, the ongoing unstable political and social conflicts within the nation, and its poor condition for investment. Korea's total ODI (on approval basis) was recorded at USD 186.53 million for 63 projects as of 2006.

Korea's ODI to Myanmar is focused on the manufacturing industry including fabrics and sewing, which takes up 58 percent of total investment. In addition to this, lodging and restaurant business are getting a considerable portion of the investment.

According to statistics from the Myanmar Investment Commission, Korea's investment to Myanmar (on approval basis) accumulated to USD 191 million as of June 2006, considered a small amount compared to its investment in other Southeast Asian countries. Korea ranks in 12th place in total foreign investment in Myanmar.

Table 12: Korea's ODI to Myanmar by sector (cumulative figure)

Sector	Acceptance		Investment	
	No. of Projects	Amounts (US$ in thousand)	No. of Projects	Amounts (US$ in thousand)
Agriculture & Fishery	1	2,793	1	506
Mining	1	170	1	170
Manufacturing	42	108,029	34	40,792
Whole Sale & Retail	14	14,547	12	13,135
Lodging & Restaurants	1	60,000	0	0
Service	4	991	3	831
Total	**63**	**186,530**	**51**	**55,434**

Source: The Export-Import Bank of Korea.

Table 13: Approved FDI to Myanmar by Country (As of June 2006)

	Amounts (US$ in million)	Share (%)
Thailand	7,375	53.39
UK	1,590	11.52
Singapore	1,434	10.38
Malaysia	660	4.78
Hong Kong	504	3.65
France	470	3.40
USA	243	1.76
Indonesia	241	1.75
The Netherlands	238	1.73
Japan	215	1.56
China	193	1.41
Korea	191	1.38
Total	13,815	100.00

Source: Myanmar Investment Commission.

3.2.5 Korea's ODI to Vietnam

Korea's ODI to Vietnam has increased drastically since Vietnam emerged as a strong newly emerging market following its *Doi Moi* reforms. Korea's ODI to Vietnam surged with the restoration of their diplomatic relation but declined after the East Asian crisis. Nevertheless, it was reactivated from 2002 and reached USD 1,755.52 million for 283 projects in 2006. Vietnam took the third spot in total Korean ODI, following China and the US. Korea's ODI to Vietnam started to expand rapidly from the end of 200 and this trend is expected to last for a while.

The manufacturing industry, including textiles and garments, machine equipment, electronics and communication equipment, and shoes and leather, receives 50 percent of total Korean ODI to Vietnam. The mining industry, which is related to oil and gas, takes up a big portion of investment, and recently, investment on construction, hotel and restaurant, and real estate is on the rise. Since 2005, when investment started to increase rapidly, investment on basic materials industry including steel manufacturing, and development of new cities and resorts for tourists exhibit an increasing trend.

Table 14: Korea's ODI to Vietnam by year (1980~2006)

Year	Acceptance		Investment	
	No. of Projects	Amounts (US$ in thousand)	No. of Projects	Amounts (US$ in thousand)
1980	2	20	2	20
1992	18	101,156	8	16,775
1993	40	115,857	17	28,017
1994	49	178,815	44	90,583
1995	46	216,076	36	182,868
1996	39	200,751	38	101,324
1997	29	180,702	25	138,883
1998	9	104,937	4	81,075
1999	18	63,785	17	40,170
2000	30	96,675	29	69,954
2001	55	98,575	47	55,475
2002	117	382,858	100	145,686
2003	101	722,351	96	155,886
2004	126	357,803	112	178,882
2005	181	384,435	172	304,458
2006	283	1,755,523	276	586,321
Cumulative	1,143	4,960,319	1,023	2,176,377

Source: The Export-Import Bank of Korea.

Korean ODI to Vietnam is mainly focused on the manufacturing industry, particularly on textiles and garments, machine equipment, electronics and communication equipment, basic metals, and shoes and leather. Investment on petrochemical products and transportation equipment has been on the rise.

Table 15: Korea's ODI to Vietnam by sector (cumulative figure)

Sector	Acceptance		Investment	
	No. of Projects	Amounts (US$ in thousand)	No. of Projects	Amounts (US$ in thousand)
Agriculture & Fishery	16	18,663	14	8,453
Mining	7	1,471,706	5	456,259
Manufacturing	913	2,516,217	818	1,359,774
Construction	48	274,647	45	52,984
Whole Sale & Retail	32	34,203	26	17,554
Transport & Storage	12	20,248	11	15,853
Telecommunications	2	15,014	1	2,819
Lodging & Restaurants	23	219,204	19	98,747
Service	69	174,637	63	53,710
Real Estate	21	215,780	21	110,224
Total	**1,143**	**4,960,319**	**1,023**	**2,176,377**

Source: The Export-Import Bank of Korea.

There are many Korean financial institutions in Vietnam as well. Based on the approval data of the Financial Supervisory Services, three local subsidiaries, four branch offices, and 11 resident offices opened in Vietnam. These institutions consist of five banks, four stock/investment trust companies, four nonlife insurance companies, and one life insurance company. Korea's investment on Vietnam's stock market has been exhibiting a drastic upsurge as well, with over USD 1 billion invested on 13 funds as of the first half of 2007.

Statistics clearly demonstrate the remarkable increase of Korea's investment to Vietnam. On approval basis, Korea emerged as number one foreign investor in Vietnam as of the second half of 2007. It was the fourth largest investor in 2005 and third in 2006. The Korean investment boom to Vietnam began toward the end of 2005. By 2006, Korea's investment to Vietnam was over USD 2.6 billion and reached USD 1.7 billion as of August 2007.

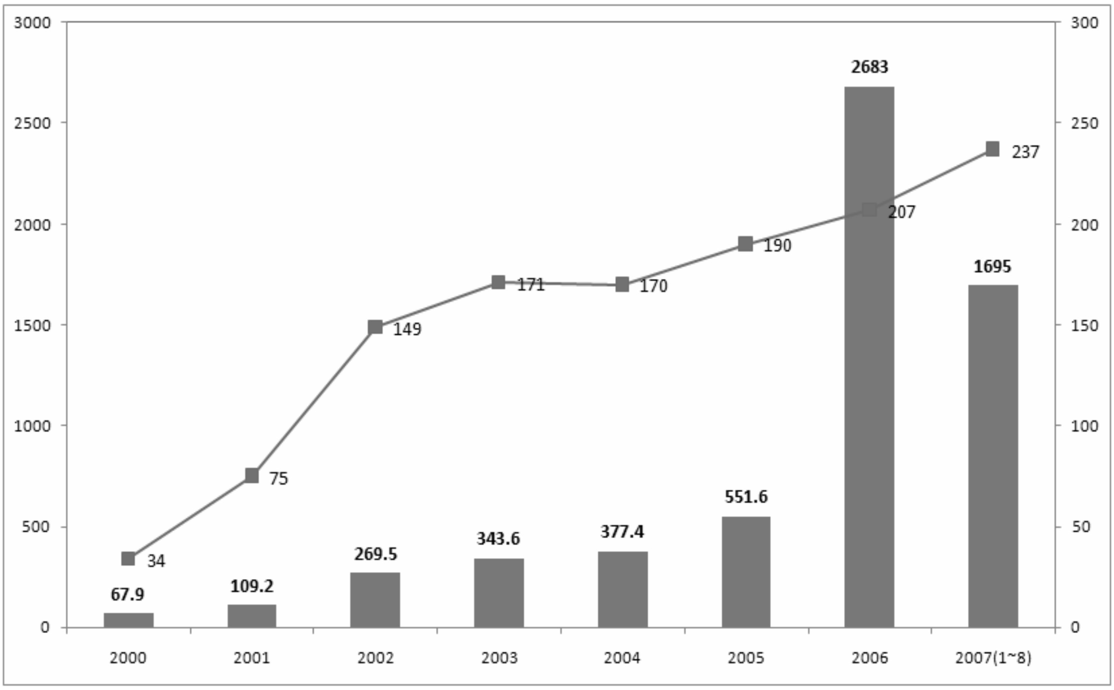
Table 16: Korea's ODI to Vietnam by manufacturing sector (cumulative figure)

	Acceptance		Investment	
	No. of Projects	Amounts (US$ in thousand)	No. of Projects	Amounts (US$ in thousand)
Food & Beverages	34	101,282	30	72,980
Textiles & Garments	320	705,881	289	436,619
Shoes & Leather	100	263,658	95	188,466
Wooden Furniture	24	15,352	23	6,506
Papers & Printing	27	32,475	23	9,719
Petrochemical products	106	169,843	97	84,377
Nonmetallic minerals	20	49,491	14	13,510
Basic metals	30	272,020	25	104,600
Fabricated metals	44	83,680	40	37,192
Machine equipment	58	314,636	52	63,566
Electronics & Communication equipment	35	294,482	28	240,412
Transportation equipment	36	128,756	34	58,891
Others	79	84,661	68	42,936
Total	**913**	**2,516,217**	**818**	**1,359,774**

Source: The Export-Import Bank of Korea.

Figure 3: Korea's investment approvals by Vietnam government

(Number, US$ in million)



Source: Ministry of Planning and Investment of Vietnam.

3.3 Tourism and the Korean Wave (Hallyu)

Since the 1990s, increased incomes from economic growth and liberalization on traveling to foreign countries have increased the Korean overseas tourism. While Southeast Asia is a popular destination of Korean tourists, CLMV countries are quickly emerging as a favorite new destination after the region opened its doors to foreigners and underwent economic reforms in the late 1990s. From year 2000, the Ha Long Bay in Vietnam, Angkor Wat in Cambodia, and Bagan in Myanmar have emerged as popular tourist destinations. Many direct flights to the region and increased ODI to these countries are the other reasons behind this booming tourism.

In particular, Vietnam and Cambodia have interested Koreans. Korean tourists to Vietnam amounted to over 420,000 out of the total of 3,580,000 foreign tourists in 2006, or 11.8 percent, the second largest group next to China. From 130,000 in 2003, Korean tourist arrivals have shown a yearly increase of 30 to 40 percent and this trend is expected to last in the future. In Cambodia, Koreans occupy the top place since they have taken 12.2 percent of the total number of foreign tourists in 2004. As of 2006, 16.7 percent of the total of 1,700,000 foreign tourists who visited Cambodia is Korean. In spite of their rich tourism resources, however, Laos and Myanmar have not been able to

Table 17: Korean tourist in Vietnam and Cambodia by year (2003~06)

		2003	2004	2005	2006
Vietnam	Tourist (1,000)	130.1	233.0	317.2	421.7
	Growth rate (%)	23.8	79.1	36.1	29.4
	Korean/Total (%)	5.4	8.0	9.1	11.8
Cambodia	Tourist (1,000)	62.3	128.4	216.6	220.9
	Growth Rate (%)		106.1	68.7	2.0
	Korean/Total (%)	8.9	12.2	15.2	16.7

Source: Ministry of Tourism of Cambodia, Vietnam National Administration of Tourism

attract Koreans due to their poor infrastructure, although the number of Korean tourist has recently shown signs of increasing.

In addition, the Korean wave or pop culture, also referred to as "Hallyu," has spread everywhere in Vietnam since the 2000s. Due to the expansion of economic and human resources exchange, the Korean culture has been spreading rapidly in Vietnam. Korea's outstanding economic achievements, its success in the World Cup, and the rapid development of its entertainment industry have all contributed to the success of the Korean pop culture. From TV dramas, movies, music, and games, to fashion and food, the Korean wave has invaded the CLMV region. Now very popular in Vietnam, the Korean wave has also begun to penetrate Myanmar and Cambodia.

4. ECONOMIC COOPERATION WITH CLMV COUNTRIES: GOVERNMENTAL COOPERATION

4.1 Korea's ODA policy and strategy toward CLMV countries

Having reached the status of a newly industrialized economy (NIE), Korea started providing official development assistance (ODA) in mid-1980s. The establishment of an Economic Development Cooperation Fund (EDCF), a kind of concessional loan, in 1987, under the auspices of the Export-Import Bank of Korea (Korea Eximbank), marked the beginning of Korea's ODA. While the EDCF provided loans to developing countries to help strengthen their industrial capacity, assist in the stabilization of their economies, and promote economic ties with Korea, the Korean government went another step forward. In 1991, it established the Korea International Cooperation Agency (KOICA), which has since then been responsible for grant-type ODA. The development assistance programs of Korea are largely managed by these two institutions. Considering the fact that (East) Asia emerged as Korea's largest trading partner, the recent ODA of Korea has concentrated in this region. To assist in the economic development and public welfare improvement in developing countries, Korea has been increasing its ODA on a regular basis. Between 1995 and 2005, it increased from USD 110 million to USD 750 million.

Table 18: ODA and EDCF primary aid recipients of Korea (2006)

Region	KOICA(18 Countries)	EDCF(11 Countries)
Asia	Vietnam, Indonesia, Philippines, Cambodia, Laos, Mongolia, Bangladesh, Sri Lanka	Vietnam, Indonesia, Philippines, Cambodia, Bangladesh, Sri Lanka, Pakistan
Latin America and the Caribbean	Guatemala, Paraguay, Peru	Guatemala, Colombia
East Europe and CIS	Uzbekistan, Kazakhstan	
West Asia		Yemen
Africa	Ghana, Ethiopia, Kenya, Congo, Tanzania	Angola

Source: The Office for Government Policy Coordination (2006).

Korea has raised the loan to Southeast Asian countries through the EDCF and has maintained close relations in politics and economy. In particular, Korea plans to include Vietnam along with Indonesia and Philippines in the category of primary aid recipients, and expand the aid for these countries after 2007. By making a Framework Agreement with these primary recipient countries, the Korean government plans to simplify the aid procedure. Meanwhile, Cambodia is selected as a secondary aid recipient. Myanmar and Laos are also included in the list of aid recipient countries.[2]

[2] In the ODA policy of Korea, primary aid recipients are selected among countries with GDP of less than 5,000 per capita and in consideration of the development potential of the recipient country, the economic cooperation level of the two countries, and diplomatic considerations. While there are

Similar to the EDCF, grant-type ODA has been enhanced for Southeast Asian countries as well. This aid has especially focused on CLMV countries to support these emerging markets and build a base to expand economic cooperation with Korea. The increasing demands for development and the high potential for economic collaboration in this region account for this aid strategy.

4.2 EDCF and grant-type ODA

4.2.1 Overall feature

From the beginning, Southeast Asia has been the biggest recipient of Korea's EDCF; about one third of EDCF has gone to this region. From a total of 80 countries worldwide, Indonesia had the biggest share; Vietnam was in third place; Cambodia was in sixth place; and Philippines was in seventh place. Myanmar and Laos were in the twelfth and twenty-eighth spots, respectively. The CLMV region has received a total of USD 494.65 million or 18 percent of the total EDCF. This ratio would be higher if the aid to Vietnam of USD 100 million in 2007 is added.

As for bilateral grant support, Southeast Asia has been the main recipient; one-fourth of total grant-type ODA has gone to this area. Again, Indonesia, Vietnam, Philippines, Cambodia, and Laos were among the main recipients. The CLMV region has received 45 percent of the aid allocated to Southeast Asia.

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currently 80 EDCF aid recipients at the end of 2006, these countries are classified into 11 primary aid recipients and 69 common countries. The selection is made by considering the income standard of the concerned participant and its economic cooperation relationship with Korea, among other criteria. The interest rate (0.5~3.0%) and repayment period (25~30 years) are applied in grades by classifying them into groups from I to V by considering their income standard, among other factors. In case of the grant administered by the KOICA, the government of the recipient country makes the request directly to the Korea government or is selected by the embassies and delegations abroad, the regional office of KOICA, or through the Ministry of Foreign Affairs.

Table 19: Korea's usage of EDCF to ASEAN by country (~2006)

Rank[1)]	Country	Loans			Overseas Investment Credit	
		No. of Projects	Amounts (US$ in million)	Share(%)[1)]	No. of Projects	Amounts (US$ in million)
1	Indonesia	13	271.70	9.8	1	1.28
3	Vietnam	10	227.96	8.1		
6	Cambodia	6	159.29	6.4		
7	Philippines	8	130.78	4.6	1	0.86
12	Myanmar	6	84.70	2.9		
28	Lao PDR	1	22.70	0.9		
ASEAN Total		**44**	**897.13**	**32.7**	**2**	**2.14**
CLMV Total		**23**	**494.65**	**18.3**		

Remark: 1) Rank and Share are from Korea's total EDCF amount.

Source: The Export-Import Bank of Korea.

Table 20: Korea's grant-type ODA to ASEAN countries by year (2000~2006)

(Approval, US$ in thousand)

Country	2000	2001	2002	2003	2004	2005	2006
Brunei	49	10	18.0	26	21	19	-
Indonesia	1,984	1,939	2,544	2,613	6,545	9,305	17,650
Malaysia	259	128	83	139	120	122	40
Philippines	2,224	3,038	1,729	5,964	6,366	5,059	6,644
Singapore	-	-	-	-	-	0.2	-
Thailand	651	599	869	904	1,990	3,150	1,349
Cambodia	637	1,057	1,467	2,341	3,341	5,813	6,328
Lao PDR	629	681	1,262	2,048	3,379	2,119	4,243
Myanmar	730	651	1,406	1,460	2,045	3,407	2,794
Vietnam	4,880	4,814	4,700	3,515	9,789	9,290	7,873
ASEAN Total	**12,043**	**12,917**	**14,078**	**19,010**	**33,596**	**38,284**	**46,921**
ASEAN/World(%)	**31.4**	**27.5**	**23.0**	**15.3**	**18.9**	**18.2**	**24.2**

Source: Korea International Cooperation Agency.

4.2.2 Country-specific features

Korea's grant to Cambodia has increased every year. Beginning 1991, Cambodia was ranked 100th in terms of the amount of grant it received from Cambodia. By 2006, it has jumped to sixth place. The main areas of aid are infrastructure construction, volunteers, and projects.

Korea's grant to Laos has been rapidly increasing as well. In 1991 when KOICA started to offer grants, Laos ranked at 114th in terms of total received. However, in 2006, it occupied the ninth spot out of 138 recipient countries. The main areas of aid are volunteers, invitation of trainees, and infrastructure construction.

Table 21: Korea's grant to Cambodia (2001~06)

Projects	Unit	2001	2002	2003	2004	2005	2006
Total Amount	1,000 USD	1,056.06	1,764.85	2,340.72	3,340.97	5,813.20	6,328.39
Infra Construction	1,000 USD	0	537.58	520.15	1,117.65	2,473.25	2,230.53
	Number	0	1	1	2	4	3
Materials, Facilities	1,000 USD	129.66	181.84	66.32	0	0	0
	Number	3	3	2	0	0	0
Taekwondo Teachers	1,000 USD	49.49	59.51	69.26	95.01	77.53	74.91
	Number	1	1	1	1	1	1
Projects	1,000 USD	429.55	228.36	960.91	686.21	939.05	1,196.67
	Number	1	2	2	3	3	3
Invitation of Trainees	1,000 USD	366.09	589.94	534.68	437.38	477.64	619.37
	Number	112	128	136	108	92	113
Invitation of Experts	1,000 USD	35.14	52.61	39.60	152.76	0	97.80
	Number	3	2	2	3	0	2
Medical Doctors	1,000 USD	46.12	115.02	121.71	145.41	150.69	81.31
	Number	1	1	1	1	1	1
Volunteers	1,000 USD	0	0	24.79	678.34	1,542.56	1,728.60
	Number	0	0	4	43	75	113
Cooperation Agents	1,000 USD	0	0	3.30	28.21	33.73	47.29
	Number	0	0	1	2	5	5
Cooperation Doctors	1,000 USD	0	0	0	0	0	49.40
	Number	0	0	0	0	0	1
Assistance to NGOs	1,000 USD	0	0	0	0	118.74	202.52
	Number	0	0	0	0	3	3

Source: Korea International Cooperation Agency.

Table 22: Korea's grant to Laos (2001~06)

Projects	Unit	2001	2002	2003	2004	2005	2006
Total Amount	1,000 USD	680.4	1,418.99	2,028.35	3,378.88	2,118.64	4,242.53
Infra Construction	1,000 USD	175.35	450.68	1,122.39	1,435.72	414.2	728.23
	Number	2	2	3	3	3	2
Materials, Facilities	1,000 USD	66.99	232.81	49.98	407.34	0	23.2
	Number	2	3	1	1	0	1
Emergency Relief	1,000 USD	10.2	0	0	0	0	0
	Number	1	0	0	0	0	0
Projects	1,000 USD	0	0	0	0	0.35	519.53
	Number	0	0	0	0	0	1
Invitation of Trainees	1,000 USD	189.7	436	297.38	277.31	268.49	731.11
	Number	59	92	75	58	58	101
Invitation of Experts	1,000 USD	0.53	0	29.1	109.03	63.96	100.18
	Number	1	0	1	1	5	2
Medical Doctors	1,000 USD	58.15	0	0	0	0	0
	Number	1	0	0	0	0	0
Volunteers	1,000 USD	137.14	193.34	329.06	920.78	1,167.29	1,985.08
	Number	7	11	14	34	49	81
Cooperation Agents	1,000 USD	8.1	65.15	94.63	113.82	104.24	99.71
	Number	4	7	11	14	12	18
Cooperation Doctors	1,000 USD	0	0	53.73	68.01	69.92	55.48
	Number	0	0	1	1	3	2
Assistance to NGOs	1,000 USD	34.24	41.02	52.08	46.88	30.19	0
	Number	1	1	1	1	1	0

Source: Korea International Cooperation Agency.

Myanmar has also been one of main recipients of Korean aid but the amount of aid is smaller than that for other East Asian countries due to Myanmar's deteriorating political and economic conditions. As of 2006, it ranked sixteenth out of 138 recipient countries. The project area takes about half of its aid amount while the rest goes to volunteers and invitation of trainees.

Table 23: Korea's grant to Myanmar (2001~06)

Projects	Unit	2001	2002	2003	2004	2005	2006
Total Amount	1,000 USD	651.2	1,574.4	1,460.42	2,045.07	3,407.37	2,794.24
Infra Construction	1,000 USD	0	0	6.81	769.36	460.77	37.03
	Number	0	0	0	2	2	1
Materials, Facilities	1,000 USD	0	151.16	7.79	20.43	13.85	0
	Number	0	1	1	1	2	0
Emergency Relief	1,000 USD	0	0	0	0	101.63	0
	Number	0	0	0	0	1	0
Projects	1,000 USD	171.82	297.81	520.35	235.59	947.33	1,441.94
	Number	1	2	2	3	3	3
Invitation of Trainees	1,000 USD	222.97	564.20	409.52	336.65	528.37	338.28
	Number	64	106	96	74	105	54
Invitation of Experts	1,000 USD	69.19	42.43	21.63	37.43	25.94	0
	Number	3	2	1	1	1	0
Medical Doctors	1,000 USD	44.58	111.32	107.40	129.49	55.04	0
	Number	1	1	1	1	1	0
Volunteers	1,000 USD	61.40	259.80	295.33	339.96	1,069.74	828.50
	Number	11	15	14	24	37	41
Cooperation Agents	1,000 USD	5.26	35.82	59.37	101.26	81.87	74.73
	Number	2	4	8	10	13	11
Taekwondo Teachers	1,000 USD	75.98	83.14	1.83	47.33	32.26	73.76
	Number	1	1	1	1	1	1
Assistance to NGOs	1,000 USD	0	28.71	30.38	27.57	90.57	0
	Number	0	1	1	1	2	0

Source: Korea International Cooperation Agency.

Since the restoration of diplomatic relation in 1992, the economic exchange between Korea and Vietnam has increased tremendously. In 1991, Vietnam ranked 104th in terms of amount of aid received. By the 2000s, it has jumped to third place out of 138 recipient countries. Foremost area of aid is infrastructure construction, which has been heavily in demand considering the growth of the economy. Other areas include volunteers, invitation of trainees, projects, and assistance to NGOs.

Table 24: Korea's grant to Vietnam (2001~06)

Projects	Unit	2001	2002	2003	2004	2005	2006
Total Amount	1,000 USD	4,814.11	4,705.65	3,514.61	9,789.17	9,289.57	7,873.33
Infra Construction	1,000 USD	2,776.47	2,393.39	1,911.04	7,035.94	5,736.51	2,856.41
	Number	7	8	7	5	8	8
Materials, Facilities	1,000 USD	0	129.78	0	0	22.24	44.23
	Number	0	2	0	0	1	1
Emergency Relief	1,000 USD	0	10.13	10.14	30.27	20.70	49.97
	Number	0	1	1	1	1	1
Projects	1,000 USD	546.11	580.33	15.09	95.04	526.85	826.20
	Number	2	2	1	1	2	3
Invitation of Trainees	1,000 USD	758.32	846.39	713.41	730.28	731.19	1,144.99
	Number	221	227	175	180	143	166
Invitation of Experts	1,000 USD	75.85	50.24	37.82	45.80	23.02	69.40
	Number	3	2	3	4	2	11
Medical Doctors	1,000 USD	0	0	0	104.76	72.63	96.57
	Number	0	0	0	1	1	1
Taekwondo Teachers	1,000 USD	44.15	55.64	58.40	72.25	23.09	0
	Number	1	1	1	1	1	0
Volunteers	1,000 USD	292.49	439.02	490.49	1,339.41	1,888.93	2,427.31
	Number	21	27	26	65	98	127
Cooperation Agents	1,000 USD	124.75	76.11	118.36	188.46	142.79	169.59
	Number	8	10	9	16	16	23
Cooperation Doctors	1,000 USD	87.67	53.25	80.85	26.56	0	0
	Number	2	2	1	1	0	0
Assistance to NGOs	1,000 USD	108.30	71.37	78.98	120.41	101.64	188.66
	Number	4	3	3	4	3	3

Source: Korea International Cooperation Agency.

4.3 Participation in programs to narrow the development gap within the East Asian region

Many programs and joint projects are being conducted in Southeast Asia to narrow the development gap. This movement has been active since the inception of the "ASEAN Plus Three (Korea, China, Japan) Framework." These programs can be classified by a program initiator or program objective, and the number of programs would increase if specific programs or enterprises by certain countries are included. The best known programs include the Greater Mekong Sub-region Economic Cooperation Program (GMS Program) by the Asian Development Bank; the ASEAN - Mekong Basin Development Forum, Initiative for ASEAN Integration (IAI), and Vientiane Action Program (2005-2010) by the ASEAN; and the Plan for Private Sector Development in the Greater Mekong Subregion by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP).

Korea has not only been working on concessional loan and grant for the least developed among developing countries (LDDC) within Southeast Asia but also participating in many projects to narrow the economic gap. Its support for the IAI and the Korea·ASEAN Cooperation Project is a good example. Korea provided IAI with USD 5 million for five projects until 2005. Korea also sent survey workers to inspect the needs for additional aid and small-area development projects. The Korea-ASEAN Cooperation Project, which began in 1990, has supplied a total of USD 34 million to about 100 projects for human resource development and technology transfer by the end of 2006. The yearly fund amount was USD 2 million, but the Korean government increased it to USD 3 million yearly in recognition of ASEAN's importance.

Table 25: Korea's assistance to IAI (5 projects)

	project name(total amounts)	recipient	amounts (USD)
1	TRN/02/005-Feasibility Study for the Missing Links and Spur Lines of the Singapore-Kunming Rail Link Project in CLMV(USD 830,000)	Cambodia Laos Myanmar Vietnam	5,000,000
2	ETF/02/003-ICT Legislation(USD 2,635,656)	Vietnam	
3	ETF/02/005-e-Government(USD 3,800,380)	Laos	
4	EFT/02/002-National ICT Development Master Plans(USD 3,800,380) * ASEAN Request: USD 5,881,824	Myanmar	
5	TRA/02/001-Capacity Building in the Trade in Goods and Trade in Services for CLMV Countries (USD 3,474,929)	Cambodia	

Source: Jaewan Cheong, Yul Kwon, Yunjong Wang, and Satoru Okuda.(2005).

5. EVALUATION AND PROSPECTS OF THE ECONOMIC COOPERATION WITH CLMV COUNTRIES

5.1 Review and sector characteristic

Korea's constant economic growth and the CLMV region's rapid economic growth as a newly emerging market call for increased economic cooperation between the two regions. Above all, exchanges in the private sector, including export and import, investment, tourism, and the diffusion of the Korean, wave, have been expanded. Governmental cooperation through EDCF and grant has increased over the years. Compared to others regions, CLMV have been a major recipient of Korean ODI. While the economic exchange between Korea and Vietnam has increased rapidly since the *Doi Moi*, that with Myanmar has been slow despite its high potential for development, due to its deteriorating political and economic situation, and the international embargo.

Some specific patterns can be found in the economic exchange between Korea and CLMV countries. First, Korea has maintained trade surplus with CMLV countries, a good example of which is the USD 3 billion worth of surplus in trading with Vietnam. The characteristics of the import-export structure follow some distinct pattern. Fabrics are one of main export items of Korea to CLMV countries. Articles of iron or steel, industrial electronic articles, special machine, and transporter are other main export items of Korea to CLMV countries. As for imports from CMLV, made-up textiles, nonferrous metal products, mineral resources, and agricultural products are among the biggest items.

Second, Korea's ODI has been focused on Vietnam. The Vietnam investment boom, which started in the second half of 2005, has been active not only on "green field-type FDI" but also on international portfolio investment (IPI) for stock and real estate. In addition, the invested sectors have been diversified from the traditional labor-intensive industries to basic materials industry such as steel, real estate development, construction, and finance. In other countries, investment is concentrated on manufacturing (Cambodia and Myanmar) and construction (Laos).

Third, in terms of governmental cooperation, CLMV countries have been receiving more support as main recipients compared to other countries. In particular, Vietnam earned the main recipient status and started to receive increased EDCF from 2007.

With the trend toward regionalism, many movements supporting economic integration have emerged in the East Asian region. However, there has not been any significant change between Korea and CLMV countries. Korea has been pursuing simultaneous and multilateral FTA and a unified FTA with ASEAN so bilateral FTA with CLMV countries seems not to be in the priority list. Meanwhile, support to narrow the development gap in the region continues to become active, as the East Asian region moves toward one unified market.

5.2 Prospects of economic cooperation with CLMV countries

The economic exchange between Korea and CLMV countries is expected to increase steadily in the future as long as there is no sudden economic depression or crisis like the one in 1997. The entire aspect of economic cooperation between the two areas such as in the field of investment cooperation and foreign trade is expected to expand. Various factors like the following would seem to make the economic cooperation between Korea and CLMV countries more active.

First, the economic growth of the two areas would continue. On top of this, the CLMV area is expected to grow even higher as a newly emerging market and accordingly, the import market of the two areas would become even greater. Second, the economic exchange between the two areas is envisaged to expand more as the pace of economic integration within the region accelerates. This is because among the areas of the Korea-ASEAN FTA, the field of commercial article has taken effect since June 2007 while the services field has also reached an agreement in 2007. Moreover, the fact that discussions for economic integration of East Asia has intensified suggests that greater economic cooperation between the two areas is underway. Third, the risks posed by China due to sudden changes in the exchange rate of the yuan, expansion of anti-foreign investment within China, increase in wages, and strong demands of the Chinese government for technology transfer are expected to shift investment priorities to CMLV countries. Specifically, Vietnam and Cambodia are anticipated to emerge as supplementary investment destinations and this will further expand Korea’s investment into CMLV. Such movement is already becoming a reality in Vietnam. Fourth, with Korea’s goal of assuming a greater role in the international community, it is expected that cooperation among the governments of the two regions will increase considerably. Most of all, because Korea has achieved much success from being a recipient of international aid after World War II to becoming an aid-giving country later, it will steadily expand ODA funds into CLMV.

6. POLICY RECOMMENDATION FOR EXPANSION OF ECONOMIC COOPERATION

6.1 Policy recommendation for Korean government

To expand the economic cooperation between Korea and CLMV countries, a steady economic growth for the latter is necessary most of all. While these development countries lack experience or knowledge of economic development, Korea has a successful experience in shifting from being a development aid recipient to a development supporter by achieving the “miracle of Han River” and being recognized globally for its information technology and infrastructure. Therefore, for a steady economic growth of CLMV countries, the support of Korea in the areas of education and training and transfer of economic development experiences is necessary. Especially, the capacity building of CLMV countries is also important.

Considering the fact that the CLMV area consists of least developed countries and the economic status of Korea is considerably higher, the support of the latter through the expansion of ODA support and the application of the GSP is very important. Korea, in fact, has been promoting to increase the ODA scale and preparing for its accession to the OECD Development Assistance Committee. Improvement of the currently operated GSP is also necessary. The preferential tariff toward least developed countries by Korea is only applicable to 480 items in 2005, is very restrictive to the extent that it has not even reached 0.1 percent, and mainly consists of the primary products manufactured by least developed countries even for the subjected item. Accordingly, the GSP is unable to materialize the initial purpose of the policy to support the industrial development of developing countries. Therefore, it is necessary to expand the GSP so that the least developed countries for which it is intended could benefit more.

Finally, improving the deepening trade imbalance between Korea and CLMV countries is necessary. Such trade imbalance is in part a consequence of the expansion of economic cooperation between the two areas. There are two explanations. First, the mechanical equipment and material parts brought by Korean companies to CMLV as part of their investment have increased rapidly. Second, a lot of machines, equipment, materials, and parts for manufacturing export products are imported by CMLV from East Asia including Korea, as part of CLMV's export-driven growth strategy centered on foreign invested companies. Despite this fact, the trade imbalance is an important problem that needs an immediate solution. To make this improvement diversification of import items by Korea is required.

6.2 Policy suggestion for CLMV countries

For CLMV countries to achieve a steady economic growth, the following policies should be prioritized.

First, the development of competent workers who are key resources to manage the national economy is necessary. Because this is a required factor for the establishment, operation, and management of economic policy from the drafting of mid- to long-term economic development plans, it should be a priority of CLMV countries.

Second, with CLMV countries shifting to a market economy system and adopting an open door policy, the improvement of foreign investment environment is required given that FDI and external trade act as driving forces of economic growth. Improving the investment environment is necessary to attract more FDI inflows, which are necessary to make up for the insufficient domestic capital and technology. To make this happen, the improvement of transportation, power and communication infrastructure, as well as law and system, is necessary.

Third, the aid provided by developed countries and international organizations is an important development resource for least developed countries. Recently, a lot of aid is going to CLMV countries. Therefore, in order to utilize such aid more effectively and properly, the systematization and development of aid management organizations is also necessary.

Fourth, continued restructuring of SOEs and further promotion of private sector participation are required. The fact that all of the CLMV countries are called "economies in transition" suggests that the restructuring of SOEs is extremely important. In addition, the extended role of the private sector is also required for a steady economic growth.

Finally, promoting the financial and capital markets is necessary. The development of the financial industry, which is in charge of mobilizing and arbitrating financial capital, is a crucial and indispensable precondition to manage the national economy efficiently. The absence of a sound financial system leads to problems in raising enough operation funds and investment capital. The introduction of an effective and clear financial policy is clearly important to bring about effective reforms in CLMV countries.

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Chapter 9

THAILAND AND ITS COOPERATIVE DEVELOPMENT STRATEGIES FOR CLMV[1]

Santi Chaisrisawatsuk

"… (I)t's important to remember the big picture: success means sustainable, equitable, and democratic development that focus on increasing living standards, not just on measured GDP. Income is, of course, an important part of living standards, but so too is health (measured, for instance, by life expectancy and infant mortality) and education."

Joseph Stiglitz,
Making Globalization Work (2006)

1. INTRODUCTION: A REVIEW OF ECONOMY-WIDE DEVELOPMENT in THAILAND

Thailand, like other developing countries, searches for policies that stimulate growth, promote income distribution, reduce poverty and vulnerability, improve quality of life and social welfare, diminish depletion of the environment and natural resources, and ensure sustainability of overall economic development, and so on. With limited available resources, Thai policymakers inevitably encounter several tradeoffs and

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[1] The introduction part of this paper was written in part by Dr. Anan Wattanakuljarus, Lecturer at School of Development Economics, National Institute of Development Administration (NIDA), Bangkok, Thailand. More details of the paper is given in "A Review of Economy-Wide Development Perspectives in Thailand" *Thai Journal of Development Administration*, forthcoming.

opportunity costs as a result of their decisions. Once they choose one option, they may lose on others. Once they solve one problem, others may arise. The forgone options and side effects should not be ignored but must be taken into account anytime they make critical decisions. Questions such as how choice of policies might affect various economic development objectives; how impacts may be brought to bear on the economy; how production and consumption patterns might change due to **choice** of policies; how factor returns and resource allocation might alter, among others, should be assessed thoroughly. By so doing, policymakers can optimize benefits and avoid mistakes in the Cambodia, Laos, Myanmar, and Vietnam (CLMV) subgrouping.

From the policy point of view, such impacts are interrelated and should be systematically observed and examined collectively in anticipation of the potential repercussions of specific decisions. One of standard approaches serving this requirement is the economy-wide approach. This first section aims to review some of many works that provide an economy-wide perspective on Thailand's economic development. Although these works apply a similar approach, they focus on different issues and views, and thus contribute distinct lessons.

The paper reviews literature that describes stylized facts and structural changes in the Thai economy, provides possible effects of national and international policies on Thailand's economic development, and illustrates some issues in specific sectors of the country. The final objective is to review major results, not methods, of these works. Although a number of literature reviewed here may seem insignificant and a lot of missing areas and contexts need to be reviewed further, at least it is the preliminary attempt to provide a preliminary study of gather several works on the economy-wide development of Thailand.

1.1 Thai Economy: Stylized Facts and Structural Changes

Facts or features of the Thai economy vary across studies, yet they are not totally unique. They share some common characteristics even as they differ in other areas. Some works attempt to describe and investigate ‘factors’ or ‘drivers’ for growth in Thailand; some examine a decline in agriculture and a rise in manufactures and services; still others study the possible side effects or adverse impacts of such structural changes on Thailand.

A study of Siksamat (1998) examines five contributions to the economic growth of the Thai economy during the period 1990-1995, namely, technology changes, changing preferences, trade, investment, and general macroeconomic situation. The study finds that the large and positive shift in exports and the favorable investment climate such as a decline in required rate of return on capital are major sources of growth. Although huge foreign direct investments or capital inflows strengthened growth in capital-intensive manufacturing and service sectors, technology as a whole contributed little to growth. This is a major concern for future policies.

The same study showed that primary agricultural sectors gained slightly from the abovementioned growth factors. One possible reason for this is the lack of industrial linkages, forward and backward, between agriculture and other growing sectors. (Evidence of the lack of linkages between booming tourism service sectors and agricultural sectors is also found in Wattanakuljarus (2006), which noted that only small benefits from tourism service sectors are distributed among agricultural and poor households.)

The above findings are similar to a work done by Diao et al. (2006), who, having explored a Ramsey growth model for Thailand, has found that the extended high growth in the country is not directly associated with advanced technology or high-skill intensity. Openness and structural changes, they said, are the main sources of such growth. In particular, these are the labor-intensive export manufacturing sector, an expansion of domestic backward linkages, and a structural shift from agriculture to exportable products.

Thailand has in fact experienced a relative decline in agriculture. This is the conclusion of Martin and Warr *(1994),* who state that supply-side influences, e.g., capital accumulation, are the most important determinants of the decline in agriculture's share of GDP. Demand-side influences, operating through relative commodity prices, are much less important. They suggest that further research on the cause of agriculture's relative decline in the process of economic development focus on the role of supply-side influences, especially factor accumulation. Their findings also bear important implications for policies affecting on economic development and structural changes.

Although agriculture becomes relatively less important to the Thai economy in terms of GDP shares compared to manufactures and services, it has contributed to the economic growth of Thailand (Warr 2006). He examines how agriculture contributes to economic growth in Thailand and Indonesia during 1981-2002. He argues that although agricultural output growth is slower than other sectors, agriculture is actually not a stagnant sector. If agriculture had really been stagnant, economic growth would have been substantially lower, because it would not have been possible to raise productivity significantly within agriculture or to release resources massively while still maintaining moderate growth of output. Warr concludes that the major contribution of agriculture to economic growth is a reallocation of resources from agriculture to other sectors (i.e., industry and services) that can use these resources more productively, rather than an expansion of agricultural outputs.

Growth and structural changes in Thailand are typically associated with environmental and natural resource problems. Therefore, Thailand's economic development should be investigated within the framework of "development – environment" relationship and vis-à-vis other economic "drivers" such as export-oriented industries (EOI), import-substituting industries (ISI), domestic-oriented industries (DOI) and factor intensity.

Coxhead and Jayasuriya (2003) view Thailand as a net food exporter with EOI policies. Thailand has natural comparative advantage in food production. Growth in manufactures is based on the expansion of labor-intensive, export-oriented manufactures. Food crops are more relatively labor-intensive while tree crops are more relatively land-intensive. The loss of forest cover or deforestation, the degradation of arable land, and the pollution and emission from agriculture and manufactures are major environmental problems for policy makers. They explain that growth of manufactures generates a large increase in labor demand which is typically met by migration from agricultural sector. This structural change raises the opportunity cost of agricultural labor. The higher labor costs tend to reduce the profitability of forest clearance for upland agriculture and to increase the relative returns to the less labor-intensive plantation crops rather than labor-intensive food production. Given this occurrence, higher labor costs tend to reduce deforestation although this may be offset to some extent by the switch to relatively land-intensive plantation crops.

Empirically, Coxhead and Jayasuriya (2003) also investigate the environmental effects of investment and trade policy reform during Thailand's economic "miracle."

They find that the growth of the Thai economy from the mid-1980s through 1997 was driven by a boom in domestic and foreign investment. They assert that "rapid growth created scale effects that have placed environmental and natural resources under tremendous stress, while the composition effects of both the investment boom and trade policy reform are mixed. Both appear to have been generally favorable for the conservation of upper-watershed and forest resources, by raising labor wages and making it more costly to engage in labor-intensive farming practices at the arable margin. These environmental gains in rural areas have been offset, to an extent, by increased demands on resources and environmental services in urban and industrial areas."

A study done by Coxhead and Plangpraphan (1998) concerns trends of land use and employment in Thai agriculture during an economic boom. They conclude that land use trends have been influenced by agricultural wage growth. Wage growth has been driven by investment in the non-agricultural sectors. The economic boom stimulated a pattern of change in economic structure that induced the terms of trade against agriculture through wage growth. The boom generated incentives for agricultural mechanization and land use shifts that may in turn have created irreversible changes in agricultural technology and the resource base. Evidence shows that cultivation of erosive and nutrient-depleting crops such as corn has actually expanded in upland and highland provinces. This expansion of a relatively low value-added crop in more remote and less productive upland and highland areas is because lower labor mobility diminished the effects of the economy-wide boom on such areas.

Thailand's economic development mentioned above is explored through structural changes and key features of Thailand. Besides, Thailand's path toward economic development is partially from national toward international policies. Side-effects and challenges of such policies are reviewed next.

1.2 Possible Effects of National and International Policies on Thailand's Economic Development and Issues in Particular Sectors of Thailand

Munasinghe and Cruz (1995) cite several country-specific studies related to the links between economy-wide policies and the environment. Firstly, Panayotou and Sussangkarn (1991) argue that without a clear description of property rights, incentive policies induced farmers to over-exploit fragile lands. Without adequate regulatory or economic instruments, an industrial growth in Thailand came with major environmental damages. Secondly, World Bank (1994) reports that the environmental impacts of economic growth on Thailand are not only determined by the scale of economic activity but also by the structure of the economy, the efficiency of input-use in energy and industry, and the types of production technologies used. The Bank further states that environmental concerns should be addressed earlier in the transition to growth so that the adverse environmental impacts of expanded economic activities can be controlled or prevented. Thirdly, short-term adverse effects of government cutbacks as a result of high government expenditures for other areas may lead to a budgetary cut for environmental activities. A study (Reed 1992) shows that a reduction in government expenditures for adequate infrastructure can increase air pollution.

The environmental effects of tax reforms in Thailand are examined by Coxhead (2000). Command-and-control measures such as emission regulation or specific location of new factories have a more significant role than environmental taxes. Consistent with the characteristics of protected industries in developing countries, the import-substituting industries (ISI) of Thailand are relatively emissions-intensive than other industries. Hence, any policies inducing a reduction of ISI's outputs should gain positive environmental effects. Thailand's ISI are relatively less labor-intensive than the economy-wide average. Based on this observation, Coxhead argues that trade liberalization can generate two benefits: 1) a reduction of emissions due to a contraction of ISI; and 2) an increase in labor demand and wage as other labor-intensive industries expand. However, he suggests that even if the environmental benefits of general trade liberalization are still uncertain due to a possible increase in overall emissions as economy expands, selective reductions in trade barriers might reduce emissions.

For decades Thailand imposed rice export tax to raise government revenues and to lower the domestic price of rice so that poor households that were not surplus rice producers could purchase. Thailand's rice export tax harmed the poor in rural and urban areas (Warr 2001), as it reduced the income of unskilled workers who worked intensively in the rice industry. Reducing the producer prices of rice also lowered the real incomes of those rice farmers who either had or had no surplus to sell. It also reduced the income of unskilled laborers engaged in non-farm activities. Such effects actually dominate the gains from imposing a cheaper consumer price of rice. Warr concludes, " Cheap food policies are not necessarily in the interests of the poor--rural or urban--because in addition to lowering the prices of staple foods, these policies can also depress the equilibrium wages of unskilled labor, and the latter effect can dominate." He adds that the effects on equilibrium wages of unskilled labor become smaller as the economy develops.

Trade liberalization. Thailand has entered into a series of trade liberalization agreements, which are either multilateral or bilateral in nature. Stoeckel et al. (1997) studied the benefits of the Asia Pacific Economic Cooperation (APEC) liberalization for

Thailand. They project that GDP growth in Thailand could be nearly 3.3 percent higher in 2020 than it might otherwise be, and exports nearly 25 percent higher and welfare over 6 percent up by 2020. Capital inflow – most of which comes from the United States and other Organisation for Economic Co-operation and Development (OECD) economies – allows Thailand to increase investment, production, and consumption. In sum, trade and investment liberalization generates significant gains for Thailand. The extra capital inflow makes the adjustment easier with careful management. They suggest policymakers and financial markets be clear about what is driving the changes as a result of liberalization. Also, the design of liberalization needs to be carefully crafted.

Secondly, trade liberalization between Thailand and Japan is a source of macroeconomic benefits for both countries, according to a report by the Japan-Thailand Economic Partnership Agreement (JTEPA) task force (December 2003). The dynamic impact of trade liberalization includes capital formation mechanism (i.e., an accumulation of induced income, savings and investment), international capital movements, and pro-competitive productivity growth effects. Gains in real terms could be more significant in Thailand, but gains in absolute terms may not be so different. The direction of the impacts on balance of payments is different between Japan and Thailand. Trade balance tends to deteriorates in Japan but improves in Thailand. There are international capital inflows in Japan but outflows in Thailand. The capital formation or liberalization of investment has macroeconomic effects for Thailand. However, successful structural adjustments such as trade reform, technical requirement, health and quality standards are essentially required for Thailand to gain from this trade liberalization.

Thirdly, according to *Australia-Thailand Free Trade Agreement: Economic Effects Report (2004)*, the gains to Thailand are larger than Australia's, because the former has higher barriers to trade, making it a less efficient economy than Australia. Thailand's GDP is projected to be 0.45 percent higher from 2020 onwards. The net present value of the stream of production and welfare gains over 20 years are worth US$6.8 billion to Thailand. It also improves efficiency in the domestic sectors, and so an increase in real investment. Investment is expected to increase 0.38 percent above baseline in 2013, and then reduce to 0.22 percent above baseline in 2026. The lowering of trade barriers is associated with more efficient domestic industries, while improving access to markets of the bilateral trading partner. All sectors experience an increase in output to meet increased consumption, export, and investment demand. The largest absolute increase in output will be in the services sector (0.7 percent higher output in 2025) due to the cost reducing effect from trade liberalization.

The above results are beneficial sides of trade liberalization. Karunaratne (1998) identified the favorable effects of trade liberalization as follows: lower wage inflation, an increase in skilled and unskilled employment, gains to owners of factors used intensively in export-oriented industries (EOI), cheaper imported inputs for EOI, an increase in manufactured exports, significant improvement in industries that had been protected during an import-substituting industrialization regime, and an improvement in income distribution. The unfavorable or side effects of trade liberalization, according to him, are loses to owners of factors used in import-substituting industries, an increase in environmental pollution, a deterioration of Thai traditional culture, and greater dependence of key sectors of the economy on foreign investments. These effects could raise serious political and social threats.

Openness to world trade requires the economy as a whole and the sectoral economies to adjust properly so that gains from trade liberalization are attained. Several changes in health and quality standards and other non-tariff barriers are challenges to policymakers and entrepreneurs. A case in point is an expansion or emergence of seafood and other non-traditional export industries. The seafood industries are natural resource-based export sectors for which the world demand has been strong and increasing (Andersson et al. 2005).

The development of Thailand's seafood industry started during the import substitution period and relied on joint-ventures with foreign companies for acquiring expertise and penetrating foreign markets. Since then the industry has received public support for production and technology transfer and is increasingly becoming an active export sector. However, issues such as natural resource management, access to sustainable raw material, and non-tariff barriers in export markets (e.g., sanitary and phyto-sanitary measures) are challenges for the industry. The active involvement of industry associations in national policymaking can help design effective policy responses to these issues, such as setting up of specialized agencies to enhance quality control and certification and an awareness of standards among producers (e.g., Thailand's National Food Institute). Industry players believe that a key factor for successful adjustment has been the pro-active role of government in establishing an enabling economic and policy environment that allows local firms to operate on a level playing field and strengthen their competitive edge in international markets.

Another booming sector in Thailand is tourism. Tourism as a development strategy in developing countries has steadily gained acceptance owing to three factors: it contributes to economic growth, improves income distribution, and benefits the environment. That the Thai economy depends on tourism could be gleaned from the fact that more than half of Thai industries benefit from tourism. Any changes in tourism could have substantial impacts on the economy. According to a study done by Wattanakuljarus (2006), a tourism boom in Thailand can stimulate real GDP. It increases imports of intermediate inputs in manufacturing, although the current account deficit declines owing to extra foreign receipts. Tourism benefits all household classes in terms of an increase in consumption, utility, and income. However, it is not pro-poor or pro-agriculture as long as the owners of primary factors in agriculture do not participate in tourism-related activities.

A tourism boom induces reallocation of primary factors toward domestic-oriented production and away from export-oriented production and import-substituting production. It widens the gap between the agriculture and non-agricultural sectors in terms of labor wages and rates of return on capital. A tourism boom stimulates demands for piped water and increases the total costs of an existing water subsidy. Wattanakuljarus finds that subsidy removal can reduce demands for piped water while causing only minimal effects on other sectors. It tends to benefit low-income and agricultural households. Hence, lifting water subsidy can be considered as a pro-poor or pro-agricultural household policy. The government can use savings from water subsidy removal to fund additional pro-poor or pro-growth projects while correcting an environmental distortion (e.g., excessive demand for water and production of wastewater). This is evidence of a double dividend.

2. THAILAND'S CONTRIBUTIONS: PAST, PRESENT, AND FUTURE

It is interesting to note what Thailand has done to narrow the development gap in the region. one of the factors that has played a significant role in this regard is trade.

Contributions through trade

Increasing trade between Thailand and its neighboring countries is seen to improve benefits from international trade, assuming trade between Thailand and its CLMV trading partners is complementary. Moreover, issues concerning GSP and the utilization rate as well as the GSP scheme, that will support sustainable economic development, will be discussed to some extent. Increasing trade through trade liberalization could lead to welfare improvement. For developing and least developed countries (LDCs), the focus of trade is to reduce poverty by increasing income level and/or better income distribution. Consideration of Thailand's contribution to narrow development gaps in CLMV will be extended to cover other aspects such as whether revenue from trade directed to the poor, supporting development process, improving conditions and creating better opportunities for economic development (import products used to build infrastructure), and promoting investment in the countries.

This section examines the nature and pattern of trade in Thailand and her LDCs trading partners, with emphasis on its CLMV neighbors, namely, Cambodia, Lao PDR, Myanmar, and Vietnam. The importance of Thailand's trade liberalization and facilitation in enhancing economic development in CLMV is also explored by examining the preferential trade agreements between Thailand and its trading partners. This includes a study on the Generalised System of Preferences (GSP) that Thailand provides for CLMV, tariff reduction either from economic integration or preferential trade agreements, and the effects of Thailand's non-tariff barriers (NTB) imposed on LDCs.

Data on trade flows and gross domestic product for each country are obtained from the *Asian Development Bank Annual Report*. More disaggregated data are collected from the United Nations Comtrade statistic database. Specific information on Thailand's tariff structure, tariff reduction, non-tariff barriers, and preferential trade agreement is derived from relevant agencies in Thailand such as the Customs department and Ministry of Finance.

Measuring openness. Trade to GDP ratio, export to GDP ratio and import to GDP ratio are indicators used to express a country's openness to international trade. The more open the country to trade, the greater are benefits to the country in terms of welfare improvement.

To determine the significance of trade on economic development, the trade to GDP ratios for Thailand and CLMV are calculated. 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 for 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 been increasing in the last decade. Furthermore, the average export and import growths for Thailand and its CLMV neighbors, from 1995 to 2006, are in double digits, ranging from 11.11 percent to 21.43 percent. Vietnam has the highest average export growth at 21.43 percent and import growth at 19.35 percent, followed by Cambodia with an average growth of export and import equal to 20.63 percent and 17.80 percent, respectively. Share of Thailand's regional trade has been increasing since 1990. Thailand's shares of exports and imports over the last decade, on average, are 5.44 percent and 6.02 percent, respectively. The contribution of Thailand to narrowing development gap in the region through trade is gleaned from the country's trade with its neighbors. Thailand's export to and import from her CLMV neighbors over the last decade are at 2.19 percent and 1.02 percent, on average, with a strong increasing trend. The number has been rising since 1990, changing only slightly during the Asian finance crisis. Thailand exports to CLMV accounted for 3.77 percent of the total in 2005, compared to 2.96 percent in 2000, 1.87 percent in 1995 and 0.48 percent in 1990. A similar pattern was noted in the share of Thailand's imports from CLMV; while the share of Thailand's imports from CLMV was 0.45 percent in 1990 and 2.21 percent in 2005.

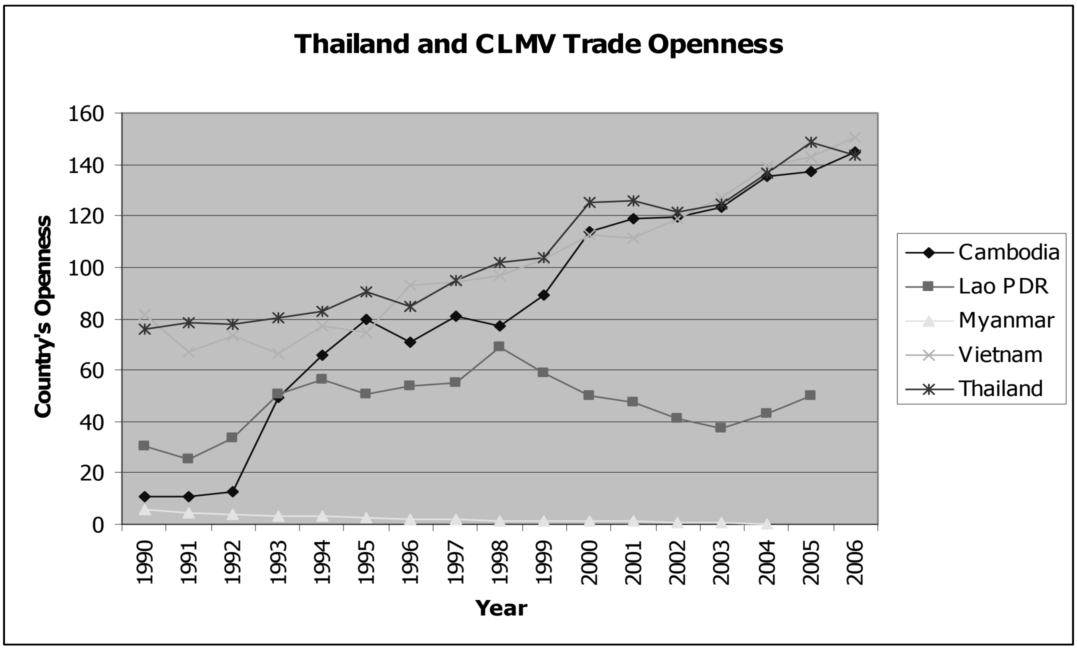
Figure 1[2] shows the trade to GDP ratio for Thailand and CLMV. In all four countries except Myanmar, the trade to GDP ratio had been increasing throughout the period 1990-2005. This suggests the increasingly important role that international trade plays in the development process alongside greater collaboration between Thailand and its neighboring LDCs. Furthermore, the numbers above show more liberalized trade in the countries above, thus moving toward developing an open, rule-based, predictable, non-discriminatory trading system.

Tables A2 and A3 (see appendix) show exports to GDP and imports to GDP ratios for CLMV and Thailand, respectively. In these countries, both export and import to GDP

[2] Details of the table are provided in the appendix.

ratios are increasing. For instance, the proportion of Cambodia's export to GDP rose from 2.4 percent in 1990 to 64.2 percent in 2005 (from 9.1 percent to 19.3 percent in Lao PDR, from 36.0 percent to 69.4 percent in Vietnam, and 34.1 percent to 73.8 percent in Thailand). Export and import have played a significant role and increasingly crucial to these economies. Cambodia, Vietnam and Thailand have export and import accounted for more than 50 percent of GDP since 2000. And thus, this suggests such a significant impact of trade liberalization on the economic development of the region particularly CLMV in narrowing development gaps.

Figure 1: Countries' Openness to trade



Poverty Reduction. An increase in volume of international trade contributes to poverty reduction by raising the income level, improving living standards, and creating more and better opportunities. Exports and imports can be viewed as an engine or a catalyze in stimulating the development of the economy. Thus, growth of exports and imports together with an increasing in GDP can be used as an indicator to signify the important of trade in reducing poverty.

Compared to developed and developing countries, LDCs' export and import growths vary widely. Generally, less fluctuation is preferable to economic development. Export and import growths for CLMV from 1995 to 2006 fluctuated to a great degree. For example, Cambodia's export growth varies from -24.6 percent to 74.3 percent despite a smoother pattern in the recent years. Thailand has experienced a more stable growth in export and import compared to its LDC neighbors. Stabilizing the growth of export and import is crucial to narrowing the development gaps in CLMV economies as well as in fostering economic stability and creating sustainable economic growth. The argument is reinforced by evidences of a more stable export and import growth in more developed economies. (Growth rates of exports and imports in Thailand and CLMV are calculated from 1995 to 2006 and expressed in Tables A4 and A5 in the appendix.)

Thailand's trade liberalization is non-discriminatory to its LDC trading partners, particularly CLMV. While a proportion of trade in regional trade is rather stable throughout the period, with an increasing international trade volume, Thailand's export and import shares with the CLMV have risen over the past decade. Table A6[3] illustrates the proportion of Thailand's export and import in world trade, regional trade, and CLMV trade. The share of Thailand's export and import in the regional trade and CLMV trade is minimal but increasing. Thailand's export and import in regional trade varies from 4.75 percent to 6.06 percent and 5 percent to 7.10 percent, respectively,

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[3] For more details see in appendix.

during 1990-2005. Moreover, while the volume of trade has been increasing, the share of Thailand's export and import in CLMV trade also steadily increased from 0.48 percent to 3.09 percent and from 0.45 percent to 1.67 percent during the same period. This implies a rising trade volume between Thailand and its LDC neighbors.

Thailand's trade with CLMV specifically has been increasing throughout the last decade. Table A7 (see the appendix) shows the amount of CLMV's export to and import from Thailand from 1985 to 2005. Although the trends of CLMV's trade with Thailand are increasing, there are fluctuations in some periods. Thailand has been in the top ten of the CLMVs' export partners from 1985 to 2005 except for Vietnam and Cambodia in recent years, and CLMV's import partners from 1985 to 2005. The evidence suggest a close and strong trade linkages between Thailand and her neighbors. Thus, the trade connection present a crucial channel in which both sides can benefit from economic integration and narrowing economic development gap.

Tables A8.1 through A8.4 , in the appendix, demonstrate the ranking and direction of exports for Cambodia, Lao, Myanmar, and Vietnam. Although Thailand does not rank in the top ten export partners of Cambodia and Vietnam, it ranks first in Lao's and Myanmar's lists, with an export value of US$ 454.7 million and US$2,134.8 million, respectively in 2006. Thailand does not rank in the top ten of Vietnam's export partners. The ranking is based on an average of export for the last the period 2002-2006. On average (from 2002 to 2006), Myanmar's export to Thailand accounted for 48.95 percent of its total exports; Lao's export to Thailand is 43.10 percent of its total export.

The ranking and direction of imports for Cambodia, Lao, Myanmar, and Vietnam are shown in Tables A9.1 through A9.4 in the appendix. Thailand ranks third in Cambodia's and first in Lao's imports, with US$ 767.4 and 1,127.6 million in 2006, respectively. The ranking is based on an average of import from 2002 to 2006. Moreover, Thailand has also contributed as a major exporter to Myanmar and Vietnam. Myanmar's and Vietnam's 2006 imports from Thailand were valued at US$837.4 and 3,407.7 million, respectively.

Measuring trade intensity index. Trade Intensity Index (TII) determines whether the value of trade between two countries is greater or smaller than expected by measuring the proportion of one country's exports going to a particular trade partner divided by the proportion of world's exports going to the trade partner. TII greater than one indicates that the bilateral trade flow between the two countries is larger than expected, i.e., the two countries are "natural" trade partners. If TII is less than one, the bilateral trade flow is smaller than expected, the two countries are not "natural" trade partners.

The trade intensity index between Thailand and ASEAN countries (see Table A10 in the appendix) shows that TII is greater than one in almost every cases. This indicates that the bilateral trade flow between Thailand and its ASEAN trading partners is larger than expected. Furthermore, there are greater trade intensities between Thailand and CLMV compared to the rest of the ASEAN, further suggesting that Thailand has been trading extensively with its LDC neighbors.

The study at a more disaggregated level illustrates that Thailand's import composition has changed in favor of LDCs, particularly CLMV. It has also been importing more from its neighbors, including its ASEAN partners. Although only in its early stage, Thailand's importation from CLMV consists only of primary or intermediate goods, these products have comparative advantages for its trading partners.

In the early 90s, Thailand incurred trade deficits with some of its LDC trading partners. However, the gaps have since narrowed or eliminated in some cases. Trade balances between Thailand and CLMV have been in favor of Thailand recently. Thailand's exports to CLMV consist of products that help improve the country's living standards as well as build infrastructure for further economic development such as foods and beverages, pharmaceutical products, cement, etc.

> **Measuring comparative advantage.** Revealed Comparative Advantage (RCA) is one of the key indicators used to measure a country's competitiveness in producing certain products. By comparing the proportion of a country's export of a specific product to the country's total export and the proportion of the world's export of the product to the world total export, the RCA index provides useful information on a country's trade potential. If the RCA index of country I for product J exceeds unity, the country is said to have a revealed comparative advantage in product J and thus there is a trade potential for product J. On the contrary, if the value of the index is less than unity, the country has a revealed comparative disadvantage and has no trade potential.

Trading according to countries' comparative advantage implies welfare improvement both to the world and the trading partners themselves. The benefits from trade are realized through more efficient allocation of resources and division of labor. Thailand has illustrated its contribution as a partner for development with its LDC neighbors in this aspect. The RCA index for the top 20 products Thailand imported from Cambodia, Lao PDR, Myanmar, and Vietnam in 2001 are calculated and shown in Tables A11.1 through A11.4 in the appendix. Almost every one of Cambodia's top 20 products exported to Thailand in 2001 has RCA greater than unity, which indicates that Thailand imports mostly the products over which the latter has trade potentials. In particular, the top five products (HS 720429, 410130, 040299, 440799 and 010290)[4] have RCAs equal to 43.22, 178.64, 27.91, 5.56 and 2.23, respectively. This suggests that greater benefits from trade expansion between Thailand and Cambodia can be captured by improving market access for these products. For Laos, Myanmar, and Vietnam, the RCA patterns are similar to Cambodia. The RCA index for the top 20 products exported to Thailand in 2001 are greater than one in most cases. The top five products Lao exported to Thailand, which account for the majority of total export to Thailand in terms of value, have RCA greater than unity, i.e., 174.85, 276.64, 153.76, 108.55 and 31.48, respectively.

Recently, Thailand has been importing significant amounts of natural gas and tin ores (HS 271121 and 260900) from Myanmar. The corresponding RCAs of these two products are 39.10 and 83.14. Vietnam's key exports to Thailand also have RCA values greater than one. Among the top 20 products Vietnam exported to Thailand in 2001, 17 products have trade potential, i.e., RCA greater than unity. The study of a country's comparative advantage, by determining the RCA index, suggests that trade expansion between Thailand and CLMV could pave the way for further benefits to the trading partners, thus highlighting the role of Thailand as an international partner for development.

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[4] Details on product description are provided in table A11.1. in the appendix

Over the last decade, the tariff structure in Thailand has undergone many reforms based on its trade agreements under APEC, AFTA, and other bilateral agreements. In addition, there are also reforms of applied Most Favored Nation (MFN) tariffs in Thailand. The reduction of tariff structure in Thailand has been a crucial factor for improving market access for its trading partners, which include not only developing countries and LDCs but also developed economies. A simple average of Thailand's tariff schedule from 1999 to 2003 is shown as follows.

	1999	**2002**	**2003**
Simple average applied rate	17%	15%	14.7%
Agricultural products (HS 01-24)	32.7%	26%	25.4%
Industrial products (HS 25-97)	14.6%	13.1%	12.9%

Source: WTO, Trade Policy Review: Thailand, 15 October 2003.

The simple applied MFN average declined from 17 percent in 1999 to 14.7 percent in 2003. Tariff on agricultural products was cut from 32.7 percent to 25.4 percent in 2003 while the average tariff rate on industrial products was reduced to from 14.6 percent to 12.9 percent in 1999.

Since CLMVs have already been accepted as new ASEAN members, the tariff structure under AFTA agreement is appropriate to these countries. The average tariff rates are calculated for products under chapter 01 to 97 (HS 2 digits) using the 2001 tariff structure. Both applied MFN tariff rates and the tariff rates implemented under AFTA are considered for comparison purposes.

	Simple average tariff rate		
	Applied rate (2001)	Agricultural products (HS 01-24)	Industrial products (HS 25-97)
Applied MFN tariff	17.19%	26.26%	14.17%
AFTA	4.53%	5.42%	4.23%

Source: Calculated by author using information obtained from the Ministry of Finance.

In terms of tariff reduction, CLMV benefits greatly from being new ASEAN members. Thailand's implementation of AFTA agreement brought down the average applied MFN rate from 17.19 percent to 4.53 percent. Compared to the applied MFN tariff rate, the AFTA average tariff is 20.84 percent lower for agricultural products, and 9.94 percent lower for industrial products.

With limited resources available, Thailand has granted GSP privileges to Bangladesh and CLMV for various products. Thailand agreed, in the first phase, to reduce the tariff rate to 0 percent and 5 percent in six product groups, which consist of 128 subgroups: 1) jute and jute products, 2) leather and leather products, 3) frozen foodstuffs, 4) ceramic products, 5) pharmaceutical items, and 6) agricultural produce. In the second phase, 10 more product groups consisting of 101 subgroups were added to the list of products whose tariff rates Thailand agreed to reduce to 5 percent, namely, 1) footwear, 2) electric cables and wire, 3) cosmetics and toiletry, 4) processed foods, 5) furniture, 6) melamine and plastic products, 7) transformers, 8) specialized textiles, 9) tea, and 10) zipper. Thailand, as an ASEAN member, has agreed to grant GSP privileges to CLMV under the ASEAN Integration System of Preferences (AISP). According to a recent revision in 2003, Thailand agreed to extend the tariff preferential rates for products listed in the AISP to CLMV for another year. Moreover, 249 products were added to the AISP list for Cambodia, 152 products for Lao, 378 products for Myanmar, and 15 products for Vietnam.

2.1 Trade and Development Index

Trade and development index in 2006 created by UNCTAD provides useful information in narrowing economic development gaps for developing countries as well as LDCs.

2.2 Input and Outcome Measure Index

A closer look at the input measure index as driving forces to simulate trade and development measured in terms of trade performance and economic and social well-being of the nation indicates similar patterns of development between Thailand and its neighbors, namely, Vietnam and Cambodia[5].

Table 1: TDI, Input and outcome measure index for Thailand, Vietnam, and Cambodia

Country		TDI		InputMI		OutcomeMI	
		2005	2006	2005	2006	2005	2006
Thailand	Score	537	551	635	657	439	445
	Rank	31	29	38	36	35	36
Vietnam	Score	496	503	563	566	428	439
	Rank	44	44	63	70	37	38
Cambodia	Score	438	452	524	538	351	365
	Rank	75	75	96	90	64	61

Note: InputMI: Input Measures Index
OutputMI: Outcome Measures Index

Source: Developing Countries in International Trade 2007: Trade and Development Index

[5] The indices for Lao PDR and Myanmar are not available as of 2007.

Table 2: Year 2006 Input and Outcome Measure Index

Input/Outcome measures		Thailand	Vietnam	Cambodia
Input Measures	Human Capital (HC)	20	19	14
	Physical Infrastructure (PI)	38	4	5
	Financial Intermediation (FI)	45	24	4
	Domestic Finance Resources (DF)	66	62	46
	International Finance Resources (IF)	102	133	139
	Institutional Quality (IQ)	59	41	44
	Economic Structure (ET)	60	52	44
	Macroeconomic Stability (MS)	101	82	91
	Environmental Sustainability (ES)	17	12	10
	Openness to Trade (OT)	72	67	69
	Market Access, Foreign (MA)	77	72	73
Outcome Measures	Trade Performance (TP)	124	104	66
	Economic and Social Well-being (EW)	321	335	299

Source: Developing Countries in International Trade 2007: Trade and Development Index

Of the three countries, Thailand has performed best in the overall performance index. However, scores on economic and social well-being are not too far apart. Vietnam and Cambodia have performed well in trade, thus scoring well on economic and social well-being. Input measures, however, point to the weakness of Cambodia in financial intermediation, physical infrastructure, environmental sustainability, and human capital. Vietnam's performance in these areas is also below par, albeit to a lesser degree. This highlights the need to enhance its trade and development efforts. Physical infrastructure improvement is still crucial to narrowing the development gap in Vietnam and Cambodia alongside accumulation of human capital.

2.3 Contributions through Investment

Aside from trade liberalization, it is also important to understand the role of investment liberalization and the relationship between trade and investment (inward and outward investment) in narrowing the development gap. Thailand's development path over the past three decades has shed some light on the crucial role of foreign investment in a host country's economic development. Thus far, Vietnam has successfully attracted foreign direct investment, which has hastened its economic growth. Many developing economies have either successfully channeled benefits derived from foreign investment to the development process, or not at all. In many cases, capital flows, especially foreign portfolio investments, have been cited as sources of instability and, worse, economic crisis. The Asian financial crisis in 1997 is a case in point. Still, it cannot be denied that developing countries need foreign capital to push forward their development process. Therefore, it illustrates how important the role of foreign investment is in narrowing the development gap.

Intra-ASEAN foreign investments in Thailand and CLMV are not uncommon, sine the region consists primarily of developing countries (with the notable exception of Singapore). As such, the development process among ASEAN members is dependent on developed economies outside the range of ASEAN. Still, it is worthwhile to note the growing share of intra-ASEAN foreign investment in CLMV, since it represents the contribution of ASEAN in narrowing the development gap. It also indicates efficiency gains from industry restructuring, especially in CLMV. Thus, emphasis should be placed on intra-ASEAN foreign investment stimulation as a means for narrowing development gap.

Thailand, along with other ASEAN members, particularly Singapore and Malaysia, and Japan, plays an important role as an investing country in CLMV. As host countries, CLMV members benefit from income growth, increasing employment, productivity improvement through efficient use of production factors and better allocation of resources. How well the CLMV as host countries utilize these benefits will be the

Table 3: Foreign Direct Investment Net Inflow, intra- and extra-ASEAN (2004-2006)

Mil. US$ / percent

Country	2004			2005			2006		
	Intra-	Extra-	Total	Intra-	Extra-	Total	Intra-	Extra-	Total
Thailand	688.7	5,173.3	5,862	762.2	8,194.8	8,957	2,822.1	7,933.9	10,756
Y-o-Y Change				10.7%	58.4%		270.2%	-3.2%	
Share	11.75%	88.25%		8.51%	91.49%		26.24%	73.76%	
Cambodia	31.9	99.5	131.4	129.2	252.2	381.4	155.5	327.7	483.2
Y-o-Y Change				304.8%	153.4%		20.4%	30.0%	
Share	24.28%	75.72%		33.88%	66.12%		32.18%	67.82%	
Lao, PDR	7.8	9.2	17	6.7	21.0	27.7	10.6	176.8	187.4
Y-o-Y Change				-13.8%	129.4%		58%	740.2%	
Share	45.88%	54.12%		24.19%	75.81%		5.66%	94.34%	
Myanmar	9.3	241.8	251.1	38.4	197.5	235.9	27.8	115.2	143
Y-o-Y Change				311.9%	-18.3%		-27.5%	-41.7%	
Share	3.70%	96.30%		16.28%	83.72%		19.44%	80.56%	
Vietnam	242.9	1,367.2	1,610.1	164.7	1,856.1	2020.8	181.9	2,178.1	2,360
Y-o-Y Change				-32.2%	35.8%		10.4%	17.3%	
Share	15.09%	84.91%		8.15%	91.85%		7.71%	92.29%	

Source: ASEAN Foreign Direct Investments Database (using data gathered from central banks, national statistical offices, and other relevant government agencies).

ultimate determinants of their development efforts. In this sense, domestic policies that ensure a favorable investment climate and consequently aster economic development cannot be emphasized enough. Thailand's contributions as a investing country are illustrated in the following table.

Table 4: Thailand's Share of Direct Investment in CLMV

Mil. US $

Cambodia		Laos		Myanmar		Vietnam*	
2005		F/Y 2005		1988-May 2006 Accumulation		2005	
Country	Amount	Country	Amount	Country	Amount	Country	Amount
China	451.96	**Thailand**	**450.91**	**Thailand**	**7,375.6**	Japan	842.22
Thailand	**81.29**	France	370.25	UK	1,591	Luxemburg	771.88
S. Korea	55.97	China	58.12	Singapore	1,434.2	S. Korea	755
Malaysia	25.87	Vietnam	43.27	Malaysia	660.7	Samoa	747.36
Singapore	25.42	Australia	21.29	Hong Kong	504.2	Taiwan	721.25
France	7.64	S. Korea	10.22	France	470.4	Hong Kong	490.42
Taiwan	7.51	Japan	4.40	USA	243.6	USA	255.61
UK	6.40	Malaysia	3.37	Indonesia	241.5	Virgin Is.	245.20
Canada	5.48	Canada	2.93	Netherlands	238.8	Singapore	238.91
USA	4.38	Singapore	1.20	Japan	215.3	Malaysia	179.59
Others	378.35	Others	279.35	Others	840.6	Others	770.66
Total	1,050.2	Total	1,245.31	Total	13,815.9	Total	6,018.10

Note: Amounts are on an approved basis. Cambodia and Laos figures include domestic investment.

* Thailand ranks 14th as investor in Vietnam

Source: Takao TSUNEISHI (2007)

Table 5: ODA to Least Developed Countries: Thailand and Selected OECD-DAC Countries (2003)

Country	ODA as % of GNI	% of ODA to LDCs	Country	ODA to LDCs as % of GNI
Norway	0.92	39	Belgium	0.35
Sweden	0.79	34	Norway	0.35
Belgium	0.60	59	Sweden	0.29
France	0.41	41	France	0.17
United Kingdom	0.34	36	Thailand	0.12
Germany	0.28	37	United Kingdom	0.12
Australia	0.25	21	Germany	0.10
Japan	0.20	22	Italy	0.08
Italy	0.17	45	Australia	0.05
United States	0.15	28	Japan	0.04
Thailand	0.13	93	United States	0.04
OECD-DAC Average	0.25	33	OECD-DAC Average	0.08

Source: Global Partnership for Development: Thailand's Contribution to Millennium Development Goal 8, Ministry of Foreign Affairs of Thailand

2.4 Contributions through Capacity Building (Infrastructure Development)

Capacity building is just as crucial to narrowing the development gap. Efforts in this regard necessarily include infrastructure development programs such as efficient transportation systems, particularly roads and rail. Admittedly, there have been infrastructure development programs in the CLMV. Yet, infrastructure improvements are still in order such as those involving network and logistics management. Key to bringing this about is collaboration among countries that share borders. This is an important condition for cluster formation and efficient industrial restructuring.

Official Development Assistance (ODA)

Thailand has performed considerably better in the efforts to assist least developed countries compared to OECD countries in relative terms as a percentage of gross national income (GNI), estimated at 93 percent of its total ODA, which far exceeds the OECD average.

3. DEVELOPMENT STRATEGY THROUGH ECONOMIC INTEGRATION

Economic integrations, particularly at the sub-regional level, have played a significant role in economic development as well as narrowing development gaps in the region. In relevant undertakings in this regard, the Great Mekong Subregion (GMS) economic cooperation stands out, based on its programs that simulate trade, investment, and capacity building, which in turn have created opportunities for CLMV countries to advance their development process.

Collaborative efforts toward economic integration have paved the way for infrastructure development such as those involving transportation. Infrastructure development alongside economic activities that include the creation of economic zones are supposed to follow along the path to economic integration. Tsuneishi (2007) outlines the investment and capacity building programs that have come on the heels of economic cooperation at the sub-regional level such as the North-South Economic Corridor (NSEC), the East-West Economic Corridor (EWEC), the Southern Economic Corridor (SEC), GMS economic cooperation (GMS-EC), and ACMECS. These sub-regional economic cooperation efforts have significantly improved the economic conditions of CLMV and successfully brought the countries onto the path to narrowing their development gaps. Although more work needs to be done, the initiation of programs under sub-regional agreements together with the provision of assistance from international organizations such as the Asian Development Bank are keys to the successful development of CLMV.

4. DEVELOPING A COHERENT DEVELOPMENT STRATEGY

Following are conclusions and proposed policy measures drawn from the foregoing discussions and evaluation of key issues in narrowing the development gap in the region.

a. *Prevent development imbalance between industry and agriculture to forestall income inequality and economic instability.* Thailand's experience brings to the fore an important lesson: Its pursuit of development following a severe economic crisis failed to stave off political unrest and economic instability.

b. *Avoid economic distortions resulting from a chaotic tariff structure.* A growing number of free trade agreement (FTA)—at the bilateral, regional, and multilateral levels, could usher in trade diversion that exceeds trade creation. Pursuing a uniform tariff structure is a viable alternative in trade agreement negotiation.

c. Harmonization of tariff structure between Thailand and CLMV accordingly with AFTA.

d. To a certain degree, it seems international trade and investment have already been utilized as a significant tool in economic development and CLMV members have already benefited from increased trade liberalization in the region. The issue then becomes how we can further benefit from international trade and investment activities, especially for CLMV, so that shrinking and finally eliminated development gaps can be achieved. In this aspect, it is crucial for the trading partners to ensure that the increasing trade activities among countries in the region are based on their comparative advantage.

e. Although physical improvement (“hardware”) is still needed in all CLMV, some are needed more than the other, a number of infrastructure development programs have been installed and now it is time to focus more on improving human capital (“software”) to better utilized the better economic environment. Building economic networking in the region will be one of the significant factors to achieve the goal of narrowing development gap.

f. Strengthening the linkages between Thailand’s regional development and Thailand economic cooperation with neighboring countries. Thus far, the existing sub-regional economic cooperation were to develop physical infrastructure needed to improve economic conditions between Thailand and CLMV particularly at the border area, i.e., building roads, bridges, and so on. However, it is lacking of regional economic development program such that better collaboration can be generated between economies in the border area. In some sense, the development programs implemented under sub-regional economic cooperation have not been fitting well with the local regional development policy. As evidences pointed out, border-trade between Thailand and CLM has increased but not being fully utilized the physical infrastructure installed up to its potential. Economic growth in the provincial area at the border has not been able to excel and catch up on development in other areas. Therefore, the objectives of narrowing development gap within the country (Thailand) need to tied up as a strategy for narrowing development gap in the region.

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APPENDIX

Table A1: Trade to GDP ratio (percent)

Year	Cambodia	Lao PDR	Myanmar	Vietnam	Thailand
1990	10.84	30.5	5.58	81.32	75.78
1991	10.47	25.4	4.42	66.95	78.47
1992	12.44	33.7	3.59	73.58	77.95
1993	49.21	50.6	3.37	66.21	80.16
1994	65.61	56	2.91	77.47	82.59
1995	79.95	50.4	2.54	74.72	90.43
1996	70.66	53.7	2.18	92.71	84.78
1997	80.94	55	1.86	94.34	94.60
1998	77.36	69.2	1.47	97.00	101.87
1999	89.18	58.8	1.06	102.79	104.02
2000	113.86	50	1.08	112.53	125.08
2001	118.88	47.3	1.00	111.56	125.70
2002	119.50	40.8	0.7	118.80	121.70
2003	123.30	37.5	0.4	127.00	124.6
2004	135.10	42.9	0.3	139.00	136.5
2005	137.10	50	-	142.90	148.9
2006	144.6	-	-	150.30	143.5

Source: Estimated figures using Asian Development Bank data, culled from various annual report issues (years).

Table A2: Export to GDP ratio (percent)

Year	Cambodia	Lao PDR	Myanmar	Vietnam	Thailand
1990	2.4	9.1	1.9	36.0	34.1
1991	4.5	9.4	1.6	30.9	36.0
1992	5.0	11.2	1.4	34.7	37.0
1993	16.4	18.1	1.2	28.7	38.0
1994	26.2	19.5	1.1	34.0	38.9
1995	31.7	17.3	0.8	32.8	41.8
1996	25.9	16.9	0.7	40.9	39.3
1997	34.4	17.9	0.6	43.1	48.0
1998	32.1	26.2	0.4	44.8	58.9
1999	38.0	20.7	0.3	50.0	58.3
2000	50.9	19.1	0.5	55.0	66.9
2001	54.4	18.2	0.5	54.6	66.1
2002	55.5	16.4	0.4	56.8	64.2
2003	56.6	15.8	0.2	59.3	65.7
2004	63.9	14.5	0.2	65.7	70.7
2005	64.2	19.3	-	69.4	73.8
2006	68.8	-	-	73.5	73.7

Source: Estimated figures using Asian Development Bank data, culled from various annual report issues (years).

Table A3: Import to GDP ratio (percent)

Year	Cambodia	Lao PDR	Myanmar	Vietnam	Thailand
1990	8.4	21.4	3.6	45.3	41.7
1991	6.0	16.0	2.9	36.0	42.5
1992	7.4	22.5	2.2	38.8	41.0
1993	32.8	32.5	2.2	37.5	42.2
1994	39.4	36.5	1.8	43.5	43.7
1995	48.2	33.1	1.7	41.9	48.6
1996	44.8	36.8	1.5	51.8	45.5
1997	46.6	37.1	1.3	51.2	46.6
1998	45.3	43.0	1.0	52.2	43.0
1999	51.1	38.1	0.7	52.8	45.7
2000	63.0	30.9	0.6	57.5	58.2
2001	64.5	29.1	0.5	56.9	59.6
2002	64.0	24.4	0.3	62.0	57.5
2003	66.7	21.7	0.2	67.7	58.9
2004	71.2	28.4	0.1	73.3	65.8
2005	72.9	30.7	-	73.5	75.1
2006	75.8	-	-	76.8	69.8

Source: Estimated figures using Asian Development Bank data, culled from various annual report issues (years).

Table A4: Growth of Exports

	Export Growth											
Countries	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Thailand	23.6	0.4	27.9	24.4	-1.4	25.2	4.0	1.4	13.7	16.5	14.6	11.4
Cambodia	74.3	-24.6	33.9	-6.9	40.9	23.6	12.5	12.6	17.9	24.1	12.4	26.8
Lao PDR	2.4	3.1	-1.4	7.7	-10.5	9.6	-3.3	-5.9	11.6	8.3	52.2	59.5
Myanmar	-6.7	8.8	17.5	4.8	32.4	42.3	34.5	16.5	-29.2	18.3	23.7	-
Vietnam	34.4	33.2	26.6	1.9	23.3	25.5	3.8	11.2	20.6	31.4	22.5	22.7

Source: Estimated figures using Asian Development Bank data, culled from various annual report issues (years).

Table A5: Growth of Imports

	Import Growth											
Countries	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Thailand	28.8	3.9	5.0	-7.8	7.5	30.8	10.4	0.8	13.1	21.1	25.1	2.5
Cambodia	59.5	-9.7	1.9	6.7	36.5	21.6	8.2	12.7	13.0	22.5	20.1	20.6
Lao PDR	4.4	17.1	-6.1	-14.7	0.3	-3.4	-4.7	-12.4	3.4	54.2	23.8	20.2
Myanmar	23.6	14.3	22.0	17.4	-3.6	-7.3	21.9	-18.9	-10.1	-15.4	1.5	-
Vietnam	40.0	36.6	4.0	-0.8	2.1	33.2	3.7	21.8	27.9	26.6	15.0	22.1

Source: Estimated figures using Asian Development Bank data, culled from various annual report issues (years).

Table A6: Share of Thailand's exports and imports in world trade, regional trade, and CLMV trade

	World Trade		Regional Trade		CLMV Trade	
Year	Exports	Imports	Exports	Imports	Exports	Imports
1990	0.67	0.97	5.10	7.10	0.48	0.45
1991	0.80	1.06	5.51	6.99	0.37	0.29
1992	0.87	1.06	5.55	6.67	0.76	0.48
1993	0.99	1.21	5.69	6.70	1.24	0.52
1994	1.06	1.27	5.88	6.78	1.70	0.58
1995	1.11	1.38	6.06	7.17	1.87	0.48
1996	1.06	1.37	5.73	7.10	2.13	0.33
1997	1.04	1.11	5.52	5.95	1.90	0.63
1998	1.00	0.77	5.52	4.89	2.26	0.92
1999	1.04	0.87	5.56	5.26	2.81	0.96
2000	1.09	0.95	5.45	5.27	2.91	1.13
2001	1.06	0.98	5.46	5.54	3.28	1.85
2002	1.07	0.97	5.29	5.32	2.90	1.78
2003	1.07	0.98	5.13	5.17	3.09	1.67
2004	1.05	1.00	4.90	5.02	3.53	1.98
2005	1.06	1.10	4.75	5.40	3.77	2.21

Source: International financial statistics (International Monetary Fund: IMF) Various issues.

Table A7: CLMV's Trade with Thailand (Mil. US$)

Year	Cambodia		Lao PDR		Myanmar		Vietnam	
	Export to	Import from	Export to	Import from	Export to	Import from	Export to	Import from
1985	-	0.4	1.1	21.7	2.4	1.5	-	-
1986	-	-	1.2	32.9	2.3	1.7	-	-
1987	-	-	5.4	40.9	1.7	1.5	-	0.2
1988	-	0.7	20.4	56.4	1.2	1.3	-	3.8
1989	2.2	0.1	39.7	70.2	1.7	1.1	15.25	2.3
1990	8.6	0.9	40.3	72.3	48.9	19.8	52.34	17.0
1991	10.5	5.1	42.7	84.3	-	4.2	57.74	14.2
1992	84.7	72.4	37.3	133.1	-	-	71.50	41.2
1993	94.9	197.3	74.8	164.8	-	-	71.77	99.5
1994	114.7	286.4	77.2	270.3	28.8	-	97.65	225.7
1995	146	367.5	83.3	287.8	36.5	-	101.30	439.8
1996	43.4	398.9	96.7	310.0	-	-	107.36	494.5
1997	131.5	198.1	34.3	336.7	-	-	235.30	575.2
1998	77	168.5	28.8	411.3	-	-	295.39	673.5
1999	18.5	195.2	51.6	452.0	102.6	435.3	312.70	561.8
2000	22.9	221.8	68.9	419.1	233.0	554.7	372.31	810.9
2001	7.6	503.9	81.0	451.7	735.4	390.5	322.77	792.30
2002	7.94	238.38	85.0	444.0	831.2	355.9	227.25	955.24
2003	11.78	215.96	94.35	501.54	826.96	483.34	335.41	1,282.19
2004	17.14	231.35	104.28	639.55	1,230.34	665.86	515.10	1,858.60
2005	7.65	141.45	204.42	846.24	1,623.04	777.30	779.70	2,393.20

Source: Asian Development Bank Annual Report (various issues 1985-2007)

Table A8.1 Cambodia's Direction of Exports (in US$ millions; calendar year)

		1	2	3	4	5	6	7	8	9	10
Year	Total	U.S.	Germany	U.K.	Hong Kong	France	Canada	Viet Nam	Japan	Singapore	Malaysia
1989	20.7	0.3	0.4	0.3	-	-	2.0	0.1	-	4.2	0.0
1990	41.7	-	0.8	0.1	0.3	-	3.2	0.9	-	7.0	0.1
1991	57.4	-	15.2	0.0	0.2	1.1	5.0	2.6	-	4.7	-
1992	165.3	0.1	24.3	0.0	0.5	5.7	8.5	3.1	7.3	6.1	0.4
1993	267.3	0.5	26.6	1.0	0.7	0.8	78.5	0.7	18.8	6.9	1.0
1994	243.1	1.0	12.3	2.4	3.9	0.1	8.0	3.6	29.4	16.1	0.7
1995	357.3	5.1	17.6	10.8	11.2	0.5	6.7	6.8	38.4	21.4	2.5
1996	292.9	4.1	41.6	31.1	13.7	1.0	6.0	11.5	43.3	16.2	4.7
1997	625.8	85.7	17.9	31.3	12.7	0.7	6.3	9.7	73.9	156.9	0.6
1998	933.5	292.9	71.8	24.9	26.8	1.9	7.9	12.2	133.0	175.9	0.6
1999	1040.1	235.8	40.4	53.4	38.3	3.2	9.3	20.7	181.7	106.8	1.8
2000	1122.7	739.7	66.0	81.6	7.3	4.9	10.7	27.7	18.0	19.4	6.4
2001	1295.8	832.2	98.7	126.3	4.5	10.4	13.3	35.0	28.0	24.5	6.7
2002	1488.7	960.4	118.2	132.7	6.0	-	18.9	38.4	26.6	32.4	-
2003	1770.7	1126.4	154.4	143.5	4.9	-	21.7	48.8	29.1	39.2	-
2004	2187.7	1312.0	237.7	175.3	5.2	94.5	25.1	62.5	10.5	42.4	30.6
2005	1368.8	665.9	77.3	52.7	333.5	62.8	47.6	22.4	6.6	18.1	13.8
2006	3344.6	2116.6	335.4	154.1	7.3	124.8	103.2	44.1	101.0	21.2	85.9

Source: Asian Development Bank Annual Report (various issues 1985-2007)

Table A8.2: Lao's Direction of Exports (in US$ millions; calendar year)

		1	2	3	4	5	6	7	8	9	10
Year	Total	Thailand	Viet Nam	France	Germany	China	Belgium	U.K.	Netherlands	Malaysia	Italy
1989	95.4	39.7	2.5	0.2	0.2	11.4	…	1.9	0.0	0.3	0.4
1990	64.4	40.3	3.6	2.5	1.7	5.9	…	0.1	0.2	0.1	0.3
1991	82.1	42.7	3.0	8.1	8.6	2.0	…	0.1	1.7	0.1	0.9
1992	103.5	37.3	7.0	12.1	5.3	3.4	…	0.3	5.7	0.1	1.3
1993	240.5	74.8	23.1	12.6	9.0	25.5	…	-	3.6	-	1.9
1994	300.4	77.2	81.2	10.3	11.8	8.1	…	0.9	5.0	-	0.7
1995	311.2	83.3	87.7	11.1	12.7	8.8	…	0.9	5.4	-	0.8
1996	320.7	96.7	157.6	8.2	4.8	0.8	…	6.6	-	-	1.0
1997	192.1	34.3	0.2	20.0	16.2	0.3	17.9	14.9	0.1	-	9.3
1998	370.8	28.8	119.5	23.3	21.4	7.2	12.7	7.7	5.4	0.0	9.5
1999	462.5	51.6	179.4	18.2	27.0	8.7	13.5	12.5	8.9	0.0	5.9
2000	391.1	68.9	96.1	27.1	20.8	5.8	13.6	7.2	10.0	0.1	9.2
2001	375.5	81.0	61.8	33.7	25.5	6.8	10.4	9.3	9.6	0.3	10.8
2002	385.9	85.0	56.9	33.8	22.0	8.8	13.6	13.4	10.6	0.4	10.1
2003	437.4	94.3	55.2	33.6	23.6	10.2	18.0	14.1	10.4	0.2	10.3
2004	535.4	104.3	67.5	43.4	28.7	11.4	13.4	26.8	10.9	0.1	11.8
2005	694.6	204.4	86.7	41.9	31.6	23.2	15.6	8.3	13.4	11.8	8.9
2006	1055.0	454.7	101.8	27.9	34.6	45.1	16.5	1.4	12.8	44.6	6.6

Source: Asian Development Bank Annual Report (various issues 1985-2007)

Table A8.3: Myanmar's Direction of Exports (in US$ millions; calendar year)

		1	2	3	4	5	6	7	8	9	10
Year	Total	Thailand	India	China	Japan	U.S.	Germany	Malaysia	U.K.	Singapore	France
1989	214.5	1.7	4.9	2.6	18.0	1.6	8.0	4.7	3.7	20.8	2.3
1990	408.7	48.9	44.2	33.3	28.4	9.4	8.7	8.6	4.7	46.2	3.3
1991	527.0	-	46.6	96.3	44.9	26.6	7.2	15.6	4.4	81.0	2.9
1992	683.6	-	94.6	119.3	43.0	37.8	9.9	17.1	8.0	98.4	3.9
1993	864.4	-	106.5	149.7	65.0	45.5	12.9	52.4	12.4	101.3	2.4
1994	939.8	28.8	109.5	129.8	68.8	66.0	16.9	25.0	19.3	127.5	4.6
1995	1197.9	36.5	145.9	136.0	85.5	79.0	24.2	37.6	13.3	192.0	7.3
1996	1183.1	-	134.9	125.0	93.9	105.6	28.2	36.3	19.5	190.7	17.2
1997	1132.1	-	168.6	66.7	90.0	112.2	34.2	51.0	29.0	157.2	33.5
1998	1138.6	-	169.4	56.0	81.3	158.9	45.0	52.1	26.3	109.1	39.3
1999	1393.3	102.6	156.5	92.3	92.2	222.2	54.4	52.2	35.0	90.3	56.3
2000	1979.3	233.0	162.9	113.5	108.4	442.7	77.8	63.2	67.3	99.8	71.3
2001	2624.7	735.4	179.8	122.0	92.8	456.2	100.3	71.1	87.4	102.1	72.1
2002	2752.5	831.2	314.2	124.5	100.3	345.4	73.1	69.8	87.8	97.3	79.5
2003	2767.3	827.0	355.2	154.1	126.9	268.6	94.0	72.6	92.6	76.2	56.7
2004	3158.8	1230.3	363.7	187.7	163.5	-	118.3	97.1	122.6	64.5	71.2
2005	3701.5	1623.0	449.1	249.5	184.8	-	102.2	121.5	58.0	98.5	39.7
2006	4361.0	2134.8	526.9	229.7	223.3	-	114.8	113.5	44.6	63.2	33.5

Source: Asian Development Bank annual report various issues.

Table A8.4: Vietnam's Direction of Exports (in US$ millions; calendar year)

		1	2	3	4	5	6	7	8	9	10
Year	Total	U.S.	Japan	China	Australia	Singapore	Germany	U.K.	Malaysia	France	Philippines
1989	2472.2	-	261.0	0.3	0.8	70.7	8.7	1.5	2.5	79.7	-
1990	2524.6	0.0	340.3	7.8	7.7	194.5	41.2	1.9	5.0	115.7	57.0
1991	2188.9	0.0	719.3	19.3	5.2	425.0	6.7	2.4	14.5	83.1	0.7
1992	2917.7	0.1	833.9	95.6	21.4	401.7	34.4	27.5	68.4	132.3	1.0
1993	2985.2	0.1	936.9	135.8	54.7	380.3	50.1	23.0	55.8	95.1	1.6
1994	4054.3	94.9	1179.3	295.7	46.0	593.5	115.2	55.7	64.8	116.8	3.6
1995	5621.4	169.7	1461.0	361.9	55.4	689.8	218.0	74.7	110.6	169.1	41.5
1996	7463.2	204.2	1546.4	340.2	64.8	1290.0	228.0	125.1	77.7	145.0	132.0
1997	9484.3	286.8	1675.4	474.1	230.4	1215.9	411.4	265.2	141.6	238.1	240.6
1998	9307.0	468.9	1514.5	440.1	471.5	740.9	552.5	335.8	115.2	297.3	401.1
1999	11541.4	504.1	1786.2	746.4	814.6	876.4	654.3	421.2	256.5	354.9	393.2
2000	14482.5	733.0	2575.2	1536.4	1272.5	885.9	730.3	479.4	413.9	382.7	478.4
2001	15019.7	1065.7	2509.8	1417.4	1041.8	1043.7	721.8	511.6	337.2	468.9	368.4
2002	16704.7	2453.2	2437.0	1518.3	1328.3	961.1	729.0	571.6	347.8	439.1	315.2
2003	20143.8	3939.6	2908.6	1883.1	1420.9	1024.7	854.7	754.8	453.8	497.2	340.0
2004	26485.0	5024.8	3542.1	2899.1	1884.7	1485.3	1064.7	1010.3	624.3	555.1	498.6
2005	32441.9	5930.6	4411.2	2916.0	2570.2	1808.5	1086.7	1015.8	949.3	652.7	829.0
2006	40202.5	8422.7	4927.5	2259.9	3656.5	1499.9	1789.9	1356.8	1286.8	872.3	959.6

Source: Asian Development Bank annual report various issues.

Table A9.1: Cambodia's Direction of Imports (Mil. US$; calendar year)

		1	2	3	4	5	6	7	8	9	10
Year	Total	Hong Kong	China	Thailand	Viet Nam	Singapore	Korea	France	Indonesia	Japan	Malaysia
1989	51.9	0.1	1.6	1.4	-	12.0	-	0.6	2.1	3.9	14.9
1990	56.0	0.9	1.8	3.3	-	10.0	-	0.1	2.9	5.0	11.4
1991	61.9	5.1	5.9	2.4	-	6.9	-	2.0	4.7	7.4	6.0
1992	751.2	72.4	24.8	14.0	276.2	7.1	-	9.4	14.8	251.7	26.0
1993	981.4	197.3	33.9	22.4	405.8	105.8	-	13.6	22.2	54.8	43.6
1994	1151.5	286.4	35.4	38.8	421.3	85.0	-	51.5	46.9	71.0	48.6
1995	1573.5	367.5	43.0	56.8	550.2	104.1	-	85.3	67.0	84.4	88.0
1996	1632.0	398.9	49.4	69.7	567.0	108.9	-	57.8	53.0	62.1	66.4
1997	1116.4	198.1	67.1	56.6	6.2	107.8	114.9	0.6	41.4	83.7	14.7
1998	1128.9	168.5	129.8	95.7	3.3	90.7	95.8	1.2	40.5	71.1	28.0
1999	1243.0	195.2	185.7	85.9	99.0	85.6	79.9	49.9	41.9	73.9	50.9
2000	1424.4	221.8	254.3	112.9	106.0	91.5	76.8	64.2	39.3	58.4	68.4
2001	1455.6	503.9	116.9	86.9	399.5	109.5	49.6	19.3	12.6	19.7	9.9
2002	1674.7	238.4	371.7	197.8	122.5	98.4	94.8	58.5	52.0	63.9	77.6
2003	1732.3	216.0	408.9	223.4	119.7	119.2	80.7	77.8	38.2	74.8	82.0
2004	2074.6	231.4	413.1	341.8	144.5	168.7	99.6	77.7	47.7	83.7	78.6
2005	1268.3	141.4	204.2	172.3	62.5	90.1	95.1	42.0	154.0	52.6	40.7
2006	4235.5	1378.1	612.1	767.4	505.6	105.7	111.6	119.2	70.2	83.1	51.1

Source: Asian Development Bank annual report various issues.

Table A9.2: Lao's Direction of Imports (in US$ millions; calendar year)

		1	2	3	4	5	6	7	8	9	10
Year	Total	Thailand	China	Viet Nam	Singapore	Japan	Australia	Germany	Korea	France	Hong Kong
1989	128.7	70.2	4.9	3.0	-	26.8	0.5	1.9	-	1.8	0.6
1990	148.6	72.3	15.9	17.6	-	21.6	1.2	1.0	-	3.1	1.3
1991	154.3	84.3	12.3	3.9	-	23.5	0.4	0.9	-	3.3	3.6
1992	258.4	133.1	30.6	17.6	4.7	30.8	15.8	1.4	-	3.3	4.1
1993	431.9	164.8	18.1	19.7	19.2	56.1	3.4	-	2.3	6.6	4.3
1994	564.1	270.3	20.2	22.5	14.7	45.8	0.4	-	2.2	5.9	7.0
1995	588.8	287.8	21.5	23.9	15.7	48.8	0.4	-	2.3	6.2	7.5
1996	689.6	310.0	23.2	25.8	16.9	52.5	0.5	-	2.5	6.7	8.1
1997	408.5	336.7	4.9	25.1	0.6	10.4	0.3	0.9	3.3	1.7	9.5
1998	644.6	411.3	19.6	80.7	22.1	21.0	2.3	15.4	5.3	6.2	8.7
1999	808.9	452.0	24.4	181.8	37.0	24.9	2.5	9.5	11.9	7.6	11.0
2000	689.8	419.0	37.9	77.7	32.9	23.6	4.2	3.6	4.9	27.5	7.9
2001	719.5	451.7	59.9	70.8	28.9	13.0	8.3	7.4	6.9	8.5	10.1
2002	722.2	444.0	59.7	71.2	29.1	19.6	12.6	4.1	4.9	8.9	6.1
2003	808.8	501.5	108.1	57.0	22.4	15.0	7.9	7.5	8.7	11.8	8.1
2004	1055.7	639.5	108.8	75.2	42.3	15.4	18.3	28.0	9.9	10.5	8.0
2005	1267.3	846.2	115.9	73.5	44.1	21.3	19.9	11.3	15.3	13.5	8.3
2006	1632.7	1127.6	185.6	86.2	45.2	22.7	20.5	12.0	18.0	11.3	15.5

Source: Asian Development Bank annual report various issues.

Table A9.3: Myanmar's Direction of Imports (in US$ millions; calendar year)

		1	2	3	4	5	6	7	8	9	10
Year	Total	China	Singapore	Thailand	Malaysia	Korea	Japan	India	Indonesia	Hong Kong	Korea
1989	194.3	6.1	11.3	1.1	5.0	0.1	75.8	0.9	0.0	1.2	3.3
1990	667.7	137.7	119.2	19.8	31.6	23.3	110.8	1.4	3.2	8.6	4.0
1991	1067.9	314.8	295.8	4.2	73.7	31.7	90.8	4.2	7.3	14.7	4.4
1992	1045.8	284.9	288.6	-	98.6	34.3	106.1	4.6	15.6	16.6	4.8
1993	1280.1	357.2	368.0	-	114.3	46.2	110.0	15.9	43.7	44.7	5.8
1994	1538.2	406.0	430.3	-	243.5	62.0	74.6	26.4	38.7	48.8	6.9
1995	2341.6	679.6	701.2	-	252.3	95.0	173.4	23.4	66.5	69.2	8.4
1996	2677.8	573.2	794.1	-	242.8	143.9	279.4	50.5	85.8	100.8	9.9
1997	2861.5	626.7	777.3	-	407.5	150.5	232.2	50.2	164.7	77.7	10.9
1998	2358.5	586.2	501.3	-	322.6	163.7	205.5	38.4	184.1	51.1	12.4
1999	2527.7	447.2	460.2	435.3	257.7	205.9	203.5	36.4	81.8	70.7	13.1
2000	3039.2	546.0	479.7	554.7	254.1	318.2	215.6	52.9	71.2	97.9	15.0
2001	2662.8	547.3	465.6	390.5	216.7	255.3	205.3	58.4	75.9	70.1	16.6
2002	2968.0	797.3	576.6	355.9	263.1	157.8	126.9	78.7	59.8	69.9	18.0
2003	3225.9	998.7	716.0	483.3	154.3	202.4	137.0	94.6	50.2	48.4	22.8
2004	3451.8	1029.2	717.1	665.9	164.3	178.2	115.8	115.2	66.3	48.7	30.0
2005	3569.1	1028.4	656.1	777.3	270.3	132.0	101.0	121.8	85.8	39.4	34.2
2006	3909.6	1328.0	619.6	837.4	181.5	154.9	105.7	142.9	107.9	44.2	40.2

Source: Asian Development Bank annual report various issues.

Table A9.4: Vietnam’s Direction of Imports (in US$ millions; calendar year)

		1	2	3	4	5	6	7	8	9	10
Year	Total	China	Singap ore	Japan	Korea	Thailan d	Malays ia	Hong Kong	U.S.	Germ any	Indon esia
1989	3032.1	-	41.3	105.6	15.6	2.3	0.9	102.6	-	5.2	0.5
1990	2842.1	4.6	497.0	169.0	53.1	17.0	0.8	196.9	0.6	118.6	9.8
1991	2482.9	18.4	722.2	157.7	152.1	14.2	6.2	194.8	1.1	101.2	49.4
1992	3027.3	31.8	821.6	239.4	211.2	41.2	35.9	142.9	2.0	40.6	39.8
1993	3924.0	85.5	1058.3	452.3	481.5	99.5	24.8	145.4	3.8	72.0	84.5
1994	5825.8	144.2	1145.9	585.7	720.5	225.7	66.1	318.6	44.3	149.1	116.3
1995	8358.5	329.7	1425.2	915.7	1253.6	439.8	190.5	419.0	130.4	175.5	190.0
1996	11284.9	329.0	2032.6	1260.3	1781.4	494.5	200.3	759.4	245.9	288.2	149.0
1997	11875.1	404.4	2128.0	1509.3	1564.5	575.2	226.8	598.9	251.5	280.8	200.0
1998	11309.8	515.0	1964.0	1481.7	1420.9	673.5	249.0	557.3	326.4	359.9	256.5
1999	11742.1	673.1	1878.5	1618.3	1485.8	561.8	305.0	504.7	323.1	268.7	286.8
2000	15636.5	1401.1	2694.3	2301.0	1753.6	810.9	388.9	598.1	364.0	295.2	345.5
2001	16217.1	1606.2	2478.3	2183.1	1886.8	792.3	464.4	537.6	411.3	396.7	289.0
2002	19744.8	2158.8	2533.5	2504.7	2279.6	955.2	683.3	804.8	458.6	558.1	362.7
2003	25255.1	3138.6	2875.8	2982.1	2625.4	1282.2	925.0	990.9	1144.1	614.6	551.5
2004	31968.8	4595.1	3618.4	3552.6	3359.4	1858.6	1215.3	1074.3	1133.9	694.3	663.3
2005	36978.0	5778.9	4597.6	4093.0	3600.5	2393.2	1258.6	1235.8	864.4	662.5	702.4
2006	47161.8	8215.2	6004.5	4480.9	4224.3	3407.7	1933.8	1661.4	1210.2	978.4	883.0

Source: Asian Development Bank annual report various issues.

Table A10: Trade Intensity Index Among ASEAN (TII)

	1997	1998	1999	2000	2001
TII (TH-CAM)	22.30	23.77	24.10	17.48	22.58
TII (CAM-TH)	6.11	2.88	1.40	0.50	0.72
TII (TH-LAO)	46.64	56.75	59.20	53.80	60.69
TII (LAO-TH)	13.23	10.00	17.34	19.10	23.30
TII (TH-MM)	13.93	11.94	13.30	18.14	11.13
TII (MM-TH)	5.99	6.05	7.71	12.07	26.22
TII (TH-VN)	3.72	4.36	3.89	4.06	3.81
TII (VN-TH)	1.49	2.68	1.84	1.93	1.76
TII (TH-BN)	2.58	2.77	-	-	-
TII (BN-TH)	2.36	1.11	-	-	-
TII (TH-IN)	2.36	3.14	3.23	3.00	3.40
TII (IN-TH)	1.22	1.94	2.11	1.75	1.96
TII (TH-MA)	2.52	2.61	2.61	2.61	2.88
TII (MA-TH)	2.78	3.20	2.76	2.87	2.84
TII (TH-PH)	1.42	2.03	2.27	2.41	2.85
TII (PH-TH)	1.61	2.25	2.16	2.46	2.84
TII (TH-SG)	3.81	3.93	3.65	3.37	3.52
TII (SG-TH)	1.85	2.33	2.41	2.08	1.90

Note: CAM = Cambodia, LAO = Lao PDR, MM = Myanmar, VN = Vietnam, BN = Brunei, IN = Indonesia, MA = Malaysia, PH = the Philippines, SG = Singapore, and TH = Thailand.

Source: Calculated using PC-TAS database.

Table A11.1: Cambodia's Top 20 exports to Thailand and its RCAs

Product Code (HS 6 digits)	Product Description	RCA (2001)
720429	Waste and scrap, of alloy steel, other than stainless	43.22
410130	Bovine hides, raw, nes	178.64
040299	Milk and cream nes sweetened	27.91
440799	Lumber, non-coniferous nes	5.56
010290	Bovine, live except pure-bred breeding	2.23
901090	Parts & accessories for apparatus & equipment for photographic laboratories	2.34
731010	Tanks, casks, drums, cans, boxes & sim contr,i or s,capac >/=50L but <300L	4.78
870422	Diesel powered trucks w a GVW exc five tones but not exc twenty tones	0.28
9999AA	National Chapter 99 data	0.09
140120	Rattans used primarily for plaiting	27.77
440722	Lumber, Okoume, Obeche, Sapelli, Sipo, Acajou d'Afrique, Makore, etc	3.67
870130	Track-laying tractors (crawlers)	2.70
470730	Waste and scrap of paper/paperboard made mainly of mechanical pulp, nes	1.08
121190	Plants & parts of plants (including seed & fruit) used in pharm, perf, insect etc nes	1.73
440690	Ties, railway/tramway, wood nes	12.18
030623	Shrimps & prawns, not frozen, in shell or not, including boiled in shell	2.53
890120	Tankers	0.27
030569	Fish nes, salted and in brine, but not dried or smoked	4.62
140110	Bamboos used primarily for plaiting	7.57
890200	Fishing vessels and factory ships	39.96

Table A11.2: Lao's Top 20 exports to Thailand and its RCAs

Product Code (HS 6 digits)	Product Description	RCA (2001)
440799	Lumber, non-coniferous nes	174.85
440722	Lumber, okoume, Obeche, sapelli, sipo, acajou d'Afrique, makore etc	276.64
440333	Logs, keruing, ramin, kapur, teak, jongkong, merbau, etc.	153.76
440399	Logs, non-coniferous nes	108.55
010290	Bovine, live except pure-bred breeding	31.48
260900	Tin ores and concentrates	259.94
440710	Lumber, coniferous (softwood) 6 mm and thicker	4.92
260800	Zinc ores and concentrates	20.55
270119	Coal nes, whether or not pulverized but not agglomerated	9.00
9999AA	National Chapter 99 data	0.28
870410	Dump trucks designed for off-highway use	14.04
440920	Wood (lumber) continuously shaped non-coniferous (hardwood)	51.07
130190	Natural gums, resins, gum-resins and balsam, except Arabic gum	265.35
441299	Panels, 1 outer ply coniferous wood nes	27.63
440110	Fuel wood	207.60
410422	Bovine leather, otherwise pre-tanned, nes	3.29
710239	Diamonds non-industrial nes excluding mounted or set diamonds	0.54
850450	Inductors, electric	1.79
121190	Plants & pts of plants(incl seed & fruit) used in pharm, perf, insect etc nes	31.13
870590	Special purpose motor vehicles nes	5.02

Table A11.3: Myanmar's Top 20 exports to Thailand and its RCAs

Product Code (HS 6 digits)	Product Description	RCA (2001)
271121	Natural gas in gaseous state	39.10
440333	Logs, Keruing, Ramin, Kapur, Teak, Jongkong, Merbau, etc	210.41
740311	Copper cathodes and sections of cathodes unwrought	11.92
270119	Coal nes, whether or not pulverised but not agglomerated	12.60
010290	Bovine, live except pure-bred breeding	12.97
440799	Lumber, non-coniferous nes	19.93
270900	Petroleum oils and oils obtained from bituminous minerals, crude	0.32
030269	Fish nes, fresh or chilled excl heading No 03.04, livers and roes	10.44
440399	Logs, non-coniferous nes	86.54
030613	Shrimps and prawns, frozen, in shell or not, including boiled in shell	36.62
410129	Hide sections, bovine, nes, fresh or wet-salted	30.18
441890	Builder's joinery and carpentry of wood nes	4.16
440722	Lumber, Okoume, Obeche, Sapelli, Sipo, Acajou d'Afrique, Makore etc	113.23
940390	Furniture parts nes	1.61
030623	Shrimps & prawns, not frozen, in shell or not, including boiled in shell	31.96
940360	Furniture, wooden, nes	1.85
260900	Tin ores and concentrates	83.14
030624	Crabs, not frozen, in shell or not, including boiled in shell	6.55
090420	Fruits of the genus Capsicum or Pimenta, dried, crushed or ground	5.29
442010	Statuettes and other ornaments of wood	5.69

Table A11.4: Vietnam's Top 20 exports to Thailand and its RCAs

Product Code (HS 6 digits)	Product Description	RCA (2001)
853710	Boards, panels, including numerical control panels, for a voltage </=1000 V	7.09
270900	Petroleum oils and oils obtained from bituminous minerals, crude	4.38
270119	Coal nes, whether or not pulverized but not agglomerated	2.14
120220	Ground-nuts shelled, whether or not broken, not roasted or otherwise cooked	13.91
410129	Hide sections, bovine, nes, fresh or wet-salted	13.99
030749	Cuttlefish and squid, shelled or not, frozen, dried, salted or in brine	31.86
270111	Anthracite, whether or not pulverised but not agglomerated	55.54
030613	Shrimps and prawns, frozen, in shell or not, including boiled in shell	33.76
391990	Self-adhesive plates, sheets, film etc, of plastic nes	0.70
850110	Electric motors of an output not exceeding 37.5 W	2.80
160510	Crab, prepared or preserved	13.97
854449	Electric conductors, for a voltage not exceeding 80 V, nes	0.51
260800	Zinc ores and concentrates	1.33
420212	Trunks, suit-cases & sim container w/outer surface of plastics/textiles	7.44
550953	Yarn of polyester staple fibers mixed with cotton, not put up, nes	14.28
730890	Structures & parts of structures, i/s (ex prefab bldgs. of head'g no.9406)	0.35
701339	Table/kitchenware (excluding drinking glasses) other than glass-ceramics nes	1.27
853400	Printed circuits	4.00
030420	Fish fillets frozen	8.62
030759	Octopus, frozen, dried, salted or in brine	17.56

Chapter 10

CHALLENGES, POROSPECTS AND STRATEGIES FOR CLMV DEVELOPMENT: THE CASE OF CAMBODIA

Chap Sotharith

ABSTRACT

After achieving peace and national reconciliation through the 1991 Paris Accord and the 1993 General Election, Cambodia has enjoyed macroeconomic and political stability for the past 10 years. Though starting from a very low base, Cambodia is considered one of the fastest-growing economies in the region with a double-digit growth for the past five years. Many reforms have been well underway for its successful transformation, from a country in intense conflict to a country in postwar reconstruction committed to peace-building and democratic reforms. However, the development challenges persist, including high poverty rate, wide income gap, low production base, and poor human resources. The country remains poor and governance weaknesses limit both critical spending and the environment for broad-based development. Growth has been narrowly based on garment exports and tourism. This paper explores the challenges, prospects, and strategies for Cambodia to narrow the development gap in the age of regional integration and globalization.

1. INTRODUCTION

Throughout her long history, Cambodia has experienced many regime changes, including coup, political strife, civil war, and genocide, which resulted in the destruction of social and economic infrastructures. With the 1991 Paris Peace Accord and the 1993 General Election, Cambodia has regained full political legitimacy, undertaking various reforms to change from a planned to a market economy and has become a member of the Association of South East Nations (ASEAN) in 1999 and the World Trade Organization (WTO) in 2004.

Cambodia has enjoyed macroeconomic stability in recent years, underpinned by prudent fiscal and monetary policies. Though starting from a very low base, Cambodian economy is considered one of the fastest-growing economies in the region, with a double-digit growth for the past five years and remarkable macroeconomic stability. Though unemployment and underemployment still exist, the economy has successfully created new jobs to absorb the rising working-age population, which has been growing faster than the population at three percent annually.

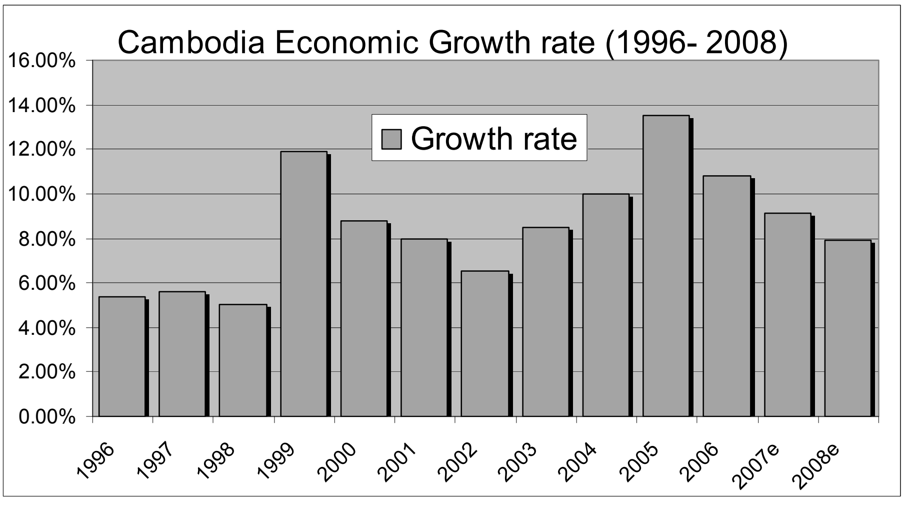
Many reforms have been well underway for its successful transformation, from a country in intense conflict to a country in postwar reconstruction committed to peace-building and democratic reforms, including economic rehabilitation especially in the new age of globalization. Nevertheless, Cambodia is still facing a huge challenge in fighting poverty, narrowing gaps in wealth among its people as well as development gaps within regions of the country, both in the rural and urban areas.

2. DEVELOPMENT TREND AND ISSUES

2.1 Macroeconomic situation

After achieving full peace in 1999, the Cambodian economy has become more resilient and dynamic despite major challenges faced by the regional and global economy and the unfavorable natural disasters in the country. For the period 2000-2006, it has achieved an average growth of approximately 9.4 per annum. In particular, during the last three years, economic growth reached unprecedented double-digit rates of 11.4 percent per year on the average, with 2005 as its peak year for reaching 13.5 percent. In 2006, economic growth was 10.8 percent and is projected to be 9.5 percent in 2007. The average per capita income almost doubled from US$288 in 2000 to US$513 in 2006. Inflation has been kept low at an average of below three percent between 2000 and 2006 (Source: Prime Minister Hun Sen's Speech at the 1st Cambodia Development Cooperation Forum, Phnom Penh, 19 June 2007). The exchange rate has been broadly stable at around 4,050 riels per US dollar. During the same period, the country's international reserves doubled from about US$500 million in 2000 to more than US$1 billion in 2006 or about three months of imports. Inflation will continue to be maintained under a five percent rate and the exchange rate will be stable.

Figure 1: Cambodia Economic Growth Rate (1996-2008)



Source: Hang (2007)

With the future oil and gas revenue expected to start in 2009 and the expansion of regional economic cooperation, Cambodia has a potential to achieve growth and poverty reduction, which will help narrow the development gap among the ASEAN member countries.

Nevertheless, at present, the economy has withstood pressures from high world oil prices, albeit with a small deterioration in the balance of payments. The external debt burden has eased to 51 percent of GDP in 2005, from a peak of 60 percent in 2003. The country remains poor and governance weaknesses limit both critical spending and the environment for broad-based development. Growth has been narrowly based on garment exports and tourism and thus while the overall poverty rate has declined—from 47 percent in 1993 to 35 percent in 2004—rural poverty remains persistently high, and many Millennium Development Goals appear beyond reach. Low revenue has led to development spending shortfalls while corruption has contributed to poor government operations and high costs of doing business (Source: IMF http://www.imf.org/external/ np/ sec/pn/2006/pn0678.htm).

Largely because of exceptionally favorable weather conditions, following a drought in 2004, agriculture output grew by around 17 percent. Contrary to earlier concerns of a large negative impact of the termination of the Multi-Fibre Agreement quotas, with the introduction of safeguard restrictions put in place for China by the United States and the European Union, garment exports continued to expand in 2005, albeit at a slower pace. After increasing by 50 percent in 2004, tourist arrivals rose by 35 percent in 2005 to nearly 1.5 million with a related increase in construction activity.

Fiscal policy was cautious, as expenditure restraint and slower donor project execution led to a decline in the overall deficit to 3.5 percent of GDP in 2005, from 4.75 percent in 2004. The deficit was again more than financed by external aid. Despite greater than budgeted tax revenues and one-off receipts from the privatization of a state bank, the revenue-to-GDP ratio in 2005 was only 10.5 percent. Expenditure declined as a share of GDP as capital spending continued its downward trend—in line with external financing—and current spending grew only moderately.

Financial intermediation continued to expand, in the context of extremely high dollarization. Broad money and bank deposits grew by about 16 percent (year-on-year) in 2005 and have picked up pace in early 2006. The banking system, however, remains relatively undeveloped and concentrated, financial intermediation remains low, and private sector credit averaged less than 10 percent of GDP in 2005, allocated mainly to the services and retail sectors.

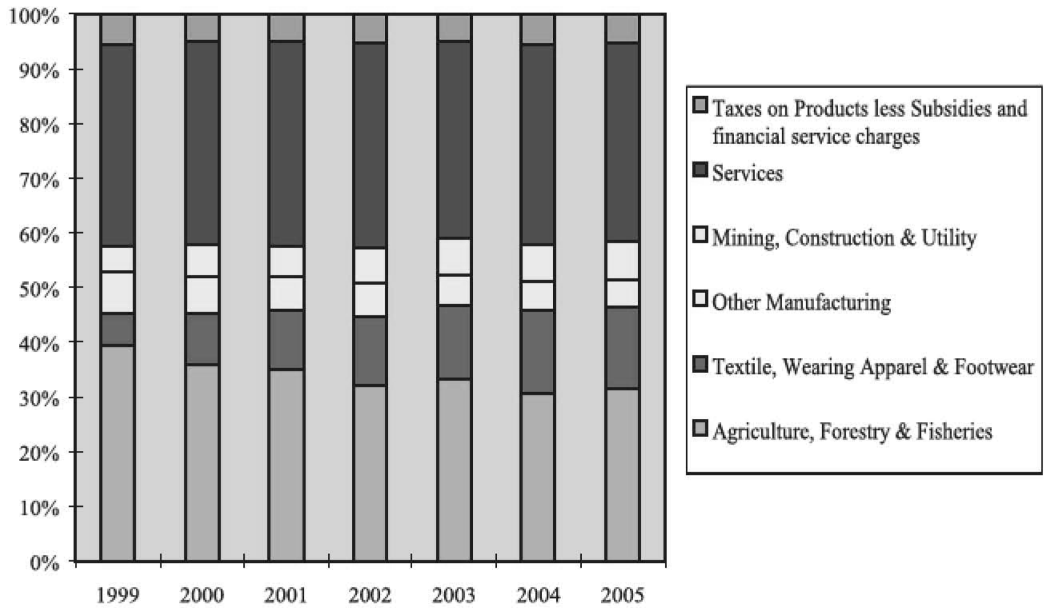
External developments were mixed. Robust tourism earnings and tourism only partly offset higher petroleum prices and strong nongarment imports. The current account deficit (excluding transfers) widened to 9.5 percent of GDP in 2005, but this was financed by an upswing in foreign direct investment (FDI), which was concentrated on the garment, tourism, and construction sectors. The riel was fairly stable both in terms of dollars and partner country currencies.

Progress has been made on the wide-ranging structural reform agenda. The authorities are implementing their flagship Public Financial Management (PFM) reform program, which addresses the weaknesses of Cambodia's public expenditure management system. In the area of land policy, the issuances of subdecrees on economic land concessions and on state land management were significant developments.

2.2 Economic Structure

Cambodia's economy is based mainly on garment export, services (in which tourism is the biggest part), and agriculture. The composition of real GDP is shown in Figure 2. Comparing real GDP composition in 1999 and 2005, the most distinctive change found is the drop in the share of agriculture, from 39.4 percent to 31.4 percent, while that of manufacturing has seen a rapid growth, from 18.0 percent to 27.0 percent (Council for the Development of Cambodia 2006).

Figure 2: Composition of GDP by Industry



Source: CDC (2006).

Growth of agriculture gross value added (GVA) increased by 28 percent, the highest agriculture sector production on record. This stellar performance was attributable to excellent weather conditions, improved irrigation, and increased acreage under cultivation. Fisheries GVA increased by 5.6 percent, and livestock and poultry GVA grew by 5.8 percent. Forestry GVA increased by 5.4 percent, with logging for domestic use being partly offset by the decrease in illegal logging for export.

As for industry, garment (and apparel) has drastically increased in share from 5.9 percent to 14.9 percent, becoming the single dominant manufacturing subsector of Cambodia. The industry sector grew by 12.1 percent in 2005, accounting for 27 percent of total GDP in constant 2000 prices. It should be noted that the share held by industry declined in 2005 owing to the exceptional growth in agriculture and services, which grew at the same rate as industry. The main contributors to the growth of the industrial sector were garment manufacturing and construction. Textiles, wearing apparel, and footwear manufacturing GVA increased by 10.3 percent in 2005 (24.9% in 2004 and 16.8% in 2003). However, export products under the Generalized System of Preferences, mainly manufactured garments, declined from 83 percent of Cambodia's total goods exports in 2004 to 82.4 percent in 2005 in constant 2000 prices. Construction GVA also made a large contribution to 2005 growth, increasing by 20.1 percent (13.2% in 2004 and 11.l% in 2003). Significant increases in construction of residential dwellings, hotels, and factories have been among the main contributors to the high GDP growth rates during the last four years.

The services sector has had a relatively stable share, between 36 percent and 38 percent, in recent years. It grew by 12.1 percent in 2005, accounting for 36.2 percent of total GDP in constant 2000 prices. Tourism continues to be the main contributor to growth in the services sector, with revenue from overseas tourists increasing by 33.6 percent in 2005 (50% in 2004). Hotels, restaurants, and other services directly benefit from tourism growth and infrastructure development. The number of tourists visiting Cambodia reached 1.4 million. Tourists, including visitors from overseas to Cambodia's casinos, contributed to the growth of the hotel and restaurant industry (17.3%), transport and communication (13.1%), and other services (17.7%). Tourism has forward and backward linkages with the service sector in general. Thus, the beneficiaries will not be just travel, hotel, restaurant, and tourist establishments but also enterprises engaged in retail trade, transportation, communication, and finance.

However, the comparison of industrial structure with other Southeast Asian nations, as shown in Table1, indicates that Cambodia is still at the initial stage of industrialization, together with Laos and Myanmar. These countries are still dependent on agriculture as the main sector.

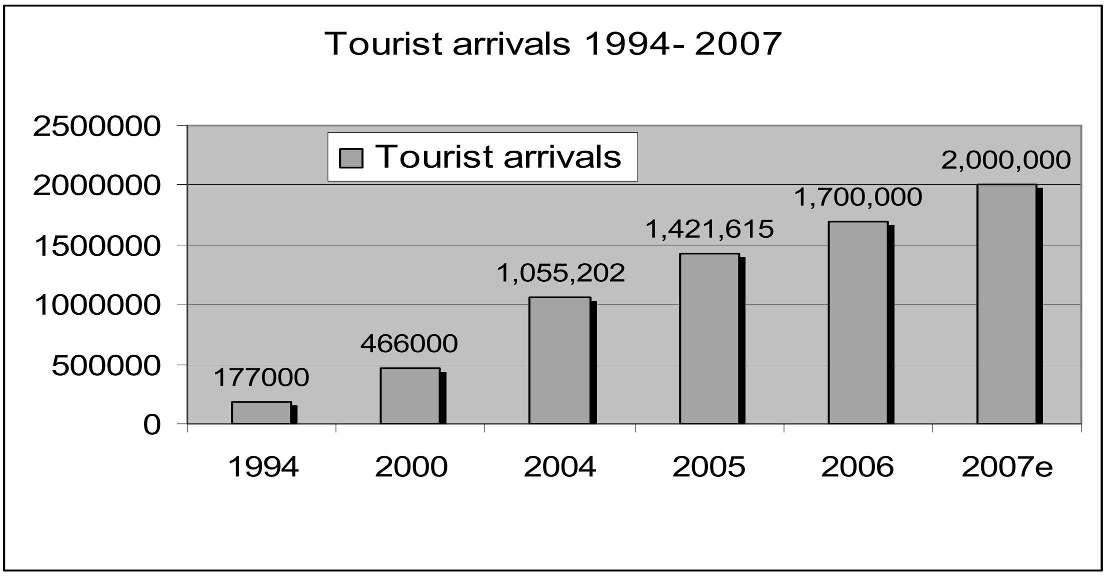
Table 1: Composition of GDP of Selected Southeast Asian Countries In 2004

	Agriculture	Industry	(Manufacturing)	Service
Cambodia	36.0	27.7	20.2	36.2
Indonesia	15.4	43.7	28.3	40.9
Laos	48.6	25.9	19.2	25.5
Malaysia	9.1	48.5	30.2	42.4
Myanmar	54.6	13.0	9.2	32.3
Philippines	15.3	31.8	23.0	52.8
Singapore	0.1	33.7	27.7	66.2
Thailand	9.9	44.1	35.2	46.0
Vietnam	21.8	40.1	20.3	38.2

Source: Asian Development Bank Key Indicators 2005.

With a great potential for tourism, especially Angkor Wat, which is regarded as one of the World's Wonders, Cambodia can use tourism as an engine of growth. Revenue from tourism amounted to more than US$2 billion in 2006 or about 20 percent of the GDP (Source: Ministry of Tourism). At 1.7 million in 2006, tourist arrivals are expected to reach 2 million in 2007, with the largest number likely to come from South Korea and Japan (See figure 3).

Figure 3: Tourist Arrivals 2004- 2007



Source: Ministry of Tourism

Progress has been made on the wide-ranging structural reform agenda. The authorities are implementing their flagship Public Financial Management (PFM) reform program, which addresses the weaknesses of Cambodia's public expenditure management system. In the area of land policy, the issuances of subdecrees on economic land concessions and on state land management were significant developments.

2.3 Trade Pattern

Cambodia's exports increased by 102 percent from 2002 to 2006 (US$1.7 billion to US$3.6 billion. Exports continued to rise at about 27.5 percent in 2006 from US$2.9 billion in 2005 due to the continued increase of textile and garment exports (Hang 2007, p.22). Garment exports increased by 18.2 percent from US$2.2 billion in 2005 to US$2.6 billion in 2006. Garment exports accounted for 75.7 percent of total export in 2006, followed by paper and pulp (18.6%) (Table 2). Cambodia's trade deficit is about US$1 billion in 2006 (Chap 2007, p.15).

Though Cambodia is an agricultural country, trade in agriculture is conducted mainly within Cambodia. It exports garment and textile products and some primary agro-product such as paddy, rice, rubber, raw fish, maize, and others. In 2006, export in agriculture covered only about one percent of total export, and was dominated by textile and apparel products (see Table 2).

The current underperformance of agricultural exports in Cambodia is the result of several problems such as high cost of production, processing, and transportation, lack of a developed marketing and postharvest system, difficulty in procurement of raw materials, widespread corruption practices, an underdeveloped financial system, and the lack of certification for Cambodian products (Ministry of Commerce 2001). In spite of all these constraints, export potential is still present and could be seized if adequate institutional, policy, and investment measures are set in place. The potential of export

Table 2: Comparison of Cambodia Export 2002 and 2006

Chapter	Section	2002 ($)	2006 ($)	% change	% of 2006

5-Jan	Live Animal	6,080,158	6,273,395	3%	0.2%
14-Jun	Vegetable Products	5,568,898	11,262,225	102%	0.3%
15	Fats and Oils	5,549	1,152,871	20677%	0.0%
16-24	Prepared Foodstuffs	3,985,993	9,485,156	138%	0.3%
25-27	Mineral Products	14,386	2,290	-84%	0.0%
28-38	Chemicals	440,259	1,404,812	219%	0.0%
39-40	Plastics	29,641,234	50,502,456	70%	1.4%
41-43	Hides and Leather	1,571,501	2,384,672	52%	0.1%
44-46	Wood and Wood articles	15,906,674	10,132,098	-36%	0.3%
47-49	Pulp and paper	423,231,534	662,468,337	57%	18.6%
50-63	Textiles and apparel	1,206,864,927	2,700,415,433	124%	75.7%
64-67	Footwear	41,963,995	67,661,560	61%	1.9%
68-70	Stone/Cement/Ceramics	32,238	1,281,611	3,876%	0.0%
71	Gems	16,525,788	15,880,087	-4%	0.4%
72-83	Base metal and Metal articles	1,141,799	4,161,898	265%	0.1%
84-85	Machinery and Electrical Appliances	7,778,520	18,242,805	135%	0.5%
86-89	Vehicles	5,466,119	582,316	-89%	0.0%
90-92	Optical, precision & musical instruments	996,637	1,010,408	1%	0.0%
93	Arms	9,250	106,321	1,049%	0.0%
94-96	Miscellaneous Manufactured articles	1,635,521	4,648,143	184%	0.1%
97-98	Antiques and works of art	287,352	376,385	31%	0.0%
	Total	**1,769,148,331**	**3,569,435,279**	**102%**	**100.0%**

Source: Using Data provided by Ministry of Commerce.

already exists in the case of high-quality rice, fishery products, live cattle, soybean, maize, rubber, sesame, and pepper.

Lack of processing plants for agro-products, lack of access to market information, and poor-quality agricultural commodities are among the biggest challenge. High domestic cost, poor infrastructure, administrative inefficiencies, and lack of investment in processing capacity all discourage formal trade. Farmers and wholesalers often take the easiest option—selling to traders from neighboring markets who are able to bear the informal costs of moving commodities out of Cambodia for processing and onward sales. The regulatory reforms that WTO membership requires, and preferential market access, should improve the situation. The global trading environment, however, is improving only gradually under WTO rules. High tariff barriers, poor quality of goods, and food safety requirements will need to be understood to take advantage of new opportunities (Ministry of Commerce and Mekong Private Sector Development Facility 2005).

2.4 Foreign Direct Investment

Information from the Council for the Development of Cambodia (CDC) shows that FDI inflows to Cambodia have been very high. Cambodia attracted about US$924 million per year from 1994 to 2007. The peak years were 1995 and 2006.

From 1998 to 2006, the actual FDI inflow to Cambodia was recorded at about US$222 million per year compared to US$1.6 billion that went to Vietnam, US$5.6 billion received by Thailand, US$3.47 billion that went to Malaysia, and US$14.4 billion given to Singapore. However, Cambodia received more FDI than Lao PDR, which received only US$47.9 million per year during the same period (see Table 4). The biggest parts of FDI are from China, Korea, and other countries in the region.

Table 3: Proposed FDI in Cambodia (1994- 2007)

Year	**FDI**	**% increase**	**Projects**	**Capital per Project**
1994	505,698,494	100	26	19,449,942
1995	2,242,890,373	344%	124	18,087,826
1996	766,662,160	-66%	188	4,077,990
1997	744,510,560	-3%	205	3,631,759
1998	853,924,698	15%	144	5,930,033
1999	356,655,269	-58%	91	3,919,289
2000	218,037,881	-39%	61	3,574,391
2001	204,683,613	-6%	39	5,248,298
2002	235,602,572	15%	32	7,362,580
2003	251,233,736	7%	47	5,345,399
2004	210,440,247	-16%	52	4,046,928
2005	962,378,619	357%	91	10,575,589
2006	3,467,851,384	260%	86	40,323,853
2007*	1,925,728,571	-44%	90	21,396,984
Total	**12,946,298,177**		**1,276**	
Average	**924,735,584**			

Source: CDC database

*Note: * From January to September 2007*

Table 4. Comparison of FDI in ASEAN (1998- 2006)

(million of USD)

Country	1998	1999	2000	2001	2002	2003	2004	2005	2006	Average 1998-2006
Brunei	573.3	747.60	549.20	526.40	1,035.30	3,123.00	212.01	288.54	433.50	832.09
Cambodia	242.9	232.30	148.50	149.40	145.10	84.00	131.38	381.22	483.24	222.00
Indonesia	-356	- 2,745.10	- 4,550.00	- 3,278.50	144.70	- 595.60	1,894.50	8,335.98	5,556.24	489.58
Lao, PDR	45.3	51.60	34.00	23.90	25.40	19.50	16.92	27.73	187.40	47.97
Malaysia	2,714.00	3,895.10	3,787.60	553.90	3,203.40	2,473.20	4,623.89	3,964.79	6,059.73	3,475.07
Myanmar	683.4	304.20	208.00	192.00	191.40	291.20	251.13	235.85	142.96	277.79
Philippines	1,718.00	1,725.00	1,345.00	982.00	1,111.00	319.00	687.80	1,854.00	2,345.01	1,342.98
Singapore	7,594.30	16,067.40	16,485.40	14,121.70	5,821.30	9,330.60	19,827.50	15,001.90	24,055.40	14,256.17
Thailand	7,491.20	7,491.20	3,350.30	3,886.00	947.00	1,952.00	5,862.00	8,957.00	10,756.06	5,632.53
Viet Nam	1,700.00	1,483.90	1,288.70	1,300.30	1,200.10	1,450.10	1,610.10	2,020.81	2,360.00	1,601.56

Source: ASEAN Statistical Year Book 2005 and ASEAN Website: http://www.aseansec.org/Stat/Table25.xls

Table 5. Comparison of GDP of ASEAN Countries

Country	1998	1999	2000	2001	2002	2003	2004	2005	2006
Brunei	3,865	4,190	4,315	4,176	5,847	6,540	7,864	9,528	11,551
Cambodia	3,027	3,427	3,546	3,702	4,028	4,634	5,311	6,250	7,257
Indonesia	97,808	140,787	150,567	143,602	204,499	237,663	251,647	280,265	364,259
Lao, PDR	1,286	1,451	1,733	1,754	1,805	2,135	2,518	2,860	3,522
Malaysia	72,237	79,149	90,320	88,001	95,266	103,992	124,750	137,180	156,924
Myanmar 2/	6,953	9,275	10,549	8,281	7,095	11,747	10,585	11,169	11,950
Philippines	65,548	76,076	74,837	71,985	76,648	79,578	86,912	98,757	117,457
Singapore	81,940	81,414	91,429	84,909	88,106	92,372	107,464	116,639	132,273
Thailand	112,751	122,698	122,969	115,601	126,880	142,863	161,386	176,207	206,645
Viet Nam	27,209	28,677	31,319	32,647	35,066	39,535	45,544	52,953	60,965

Source: ASEAN Statistical Year Book 2005 and ASEAN Website: http://www.aseansec.org/Stat/Table5.xls

Table 6. Comparison of FDI per GDP of ASEAN Countries

Country	1998	1999	2000	2001	2002	2003	2004	2005	2006	Average 1998-2006
Brunei	14.8%	17.8%	12.7%	12.6%	17.7%	47.8%	2.7%	3.0%	3.8%	14.8%
Cambodia	8.0%	6.8%	4.2%	4.0%	3.6%	1.8%	2.5%	6.1%	6.7%	4.9%
Indonesia	-0.4%	-1.9%	-3.0%	-2.3%	0.1%	-0.3%	0.8%	3.0%	1.5%	-0.3%
Lao, PDR	3.5%	3.6%	2.0%	1.4%	1.4%	0.9%	0.7%	1.0%	5.3%	2.2%
Malaysia	3.8%	4.9%	4.2%	0.6%	3.4%	2.4%	3.7%	2.9%	3.9%	3.3%
Myanmar 2/	9.8%	3.3%	2.0%	2.3%	2.7%	2.5%	2.4%	2.1%	1.2%	3.1%
Philippines	2.6%	2.3%	1.8%	1.4%	1.4%	0.4%	0.8%	1.9%	2.0%	1.6%
Singapore	9.3%	19.7%	18.0%	16.6%	6.6%	10.1%	18.5%	12.9%	18.2%	14.4%
Thailand	6.6%	6.1%	2.7%	3.4%	0.7%	1.4%	3.6%	5.1%	5.2%	3.9%
Viet Nam	6.2%	5.2%	4.1%	4.0%	3.4%	3.7%	3.5%	3.8%	3.9%	4.2%

Source: Table 4 and Table 5

It is very difficult to compare the FDI inflow among countries with different sizes of economies. One US$ billion invested in Thailand is quite different with the same amount invested in Cambodia. To be fair, FDI can be measured by using FDI per GDP as the basis for comparison. Using the figures of FDI in ASEAN countries (Table 4) and the GDP in ASEAN countries (Table 5), the result is presented in Table 6.

Based on this method, Cambodia was the third highest FDI recipient in the ASEAN, next to Brunei and Singapore from 1998 to 2006. In Cambodia, FDI covers 4.9 percent of the GDP compared with 14.8 percent in Brunei and 14.4 percent in Singapore (see Table 6).

The figures received from the official documents of the CDC only indicate registered capital or pledges made by investor to make the project look attractive for incentives. The investors may exaggerate the amount of investment capital in their applications to gain better incentives from the government as the policy states that the more investment capital is made, the more incentive the government will offer. No data were available on actual or realized FDI from the CDC (Chap 2005, p.37).

Some investors were in a hit-and-run position with money laundering and speculation for a quick profit. “Sincere” investors also face problems with uncertainty of risks and hesitation to invest in the country. Many middlemen (intermediaries) who have a close link with the Government are involved in corruption to get licenses and concessions, especially for the exploitation of natural resources (forestry, mining, etc). They sell the licenses for a profit, or delay or cancel them completely if they could not find potential buyers.

3. ECONOMIC DEVELOPMENT POLICY

3.1 Five-Year Plans

Cambodia has implemented its five-year plans, namely: first Socio-Economic

Development Plan, SEDP I (1996-2000); second Socio-Economic Development Plan, SEDP II (2001-2005); and the third five-year plan, whose name has been changed to National Strategic Development Plan, NSDP (2006-2010). The third five-year plan, NSDP, focuses on the following three main points: (1) to speed up and ensure sustainable economic growth of 6-7 percent per annum; (2) to implement population policy adopted by the Royal Government by focusing on birth spacing and ensuring the quality and health of human resources; and (3) to rigorously implement governance reform especially corruption eradication to equally distribute economic outcome (Royal Government of Cambodia 2006). The NSDP has integrated many policy instruments such as Rectangular Strategy, 73-point Government Political Agenda, Cambodian Millennium Development Goal, and National Poverty Reduction Strategy.

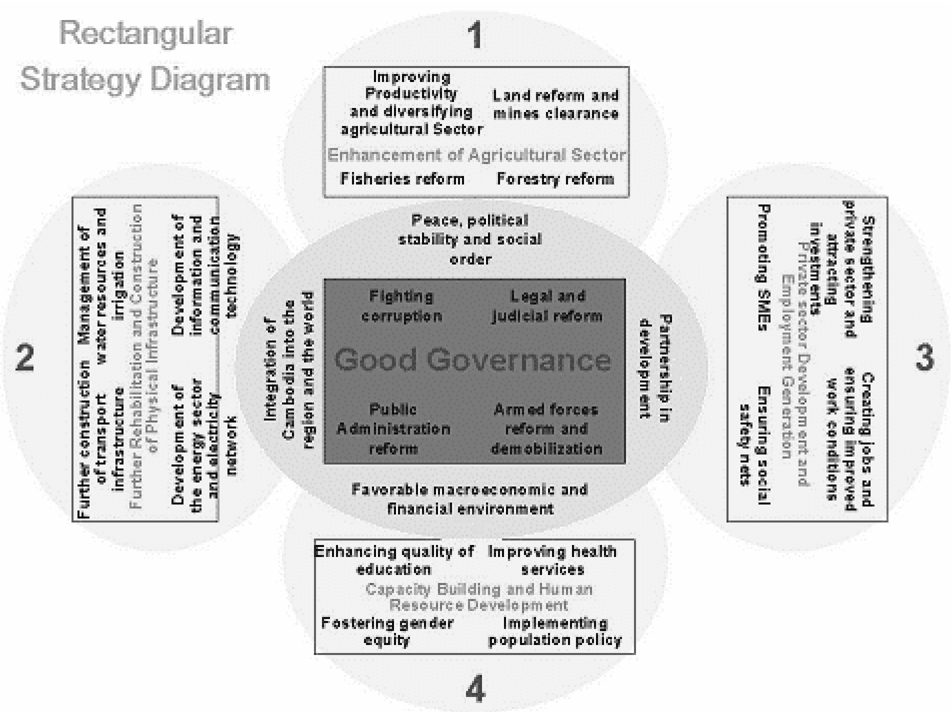
3.2 Development Strategies

The Government of the second legislative (1997-2003) used a political strategy called the *triangular strategy* (1997-2003) consisting of political stability, economic integration, and poverty reduction. The present Government (2003-2008) is implementing the so-called "Triangular Strategy" with the motto of "for growth, employment, equity, and efficiency."

The rectangular strategy is an integrated structure of interlocking rectangles, as follows:

First, the core of the *rectangular strategy* is good governance, focused at four reform areas: (1) anticorruption, (2) legal and judicial reform, (3) public administration, and (4) reform of the armed forces, especially demobilization. Second, the overall environment for the implementation of the rectangular strategy consists of four elements: (1) peace, political stability, and social order; (2) partnership in development with all stakeholders, including the private sector, donor community, and civil society; (3) favorable economic and financial environment; and (4) the integration of Cambodia into the region and the world. Third, the four strategic "growth rectangles" are: (1) enhancement of agricultural sector; (2) private sector development and employment generation; (3) continued rehabilitation and construction of physical infrastructure; and (4) capacity building and human resource development (see Figure 4).

Figure 4: Rectangular Strategy of Royal Government of Cambodia (2003- 2008)



Source: Council for Administration Reform

3.3 Regional and Global Integration

The Royal Government is committed to integrate Cambodia into the regional and global economies, specifically focusing on bridging the development gaps among member countries of the ASEAN by promoting full partnership in the implementation of the various elements of the Initiatives for ASEAN Integration as adopted by the ASEAN Summits, in particular the measures and projects adopted by the 8th Summit in November 2002 in Phnom Penh. The Royal Government will also continue its active participation in the implementation of the Greater Mekong Sub-region Program, especially the flagship programs adopted by the 1st Summit of Greater Mekong Sub-region Program in Phnom Penh in November 2002, and the projects under the "Development Triangle Zones" among Cambodia, Viet Nam, and Lao PDR, the "Development Triangle Zones" among Cambodia, Lao PDR, and Thailand, and the "Economic Cooperation Strategy" among Cambodia, Lao PDR, Thailand, and Myanmar. To maximize the gains from international integration, Cambodia must strengthen its institutional capacity to implement cooperative strategies with neighboring countries such as the concept of "Four Countries-One Economy," the creation of the triangles for economic growth, and the establishment of cross-border Economic Processing Zones (Royal Government of Cambodia 2004).

There is worldwide recognition that free trade significantly contributes to the reduction of poverty and improvement of the living standards of the people. Thus, the Royal Government will continue to liberalize trade and ensure free flow of goods and services both within the country and between Cambodia and other key partners in the region and the world. Increasing the unfettered access of Cambodian products to the regional and world markets will provide Cambodia with the economies of scale and opportunities that attract investment, create employment, generate increased incomes, and promote accelerated economic growth that will result in poverty reduction. Indeed, Cambodia's participation in the ASEAN Free Trade Area (AFTA) and accession to the WTO constitute strategic and historical steps in the rehabilitation and development of Cambodia.

The Royal Government will strictly implement its obligations under the WTO, recognizing that Cambodia's membership in the WTO requires great efforts in the formulation, adoption, and implementation of laws, regulations, procedures, and methodology for valuation, assessment report on the effects of trade protection, studies on rice production and agricultural markets, agricultural value chain analysis, handicrafts, pure drinking water, fisheries, factories, tourism, and other labor services that Cambodia can benefit from the WTO. The Royal Government is strongly committed to using this opportunity to embark on reforms in all sectors.

4. COUNTRY'S STRENGTH IN COMPETITIVENESS

(1) Competitive Advantages

Cambodia has potentials for development in many sectors such as agriculture, agro-industry, tourism, and labor-intensive industry. Cambodia is located in the fastest-growing economic region of the world in which foreign and investment interlinkages are higher than in any other developing regions. The country is also relatively richly endowed with agricultural, forest, and marine resources, and thus possesses a good foundation for a range of natural resource-based industrial processing activities.

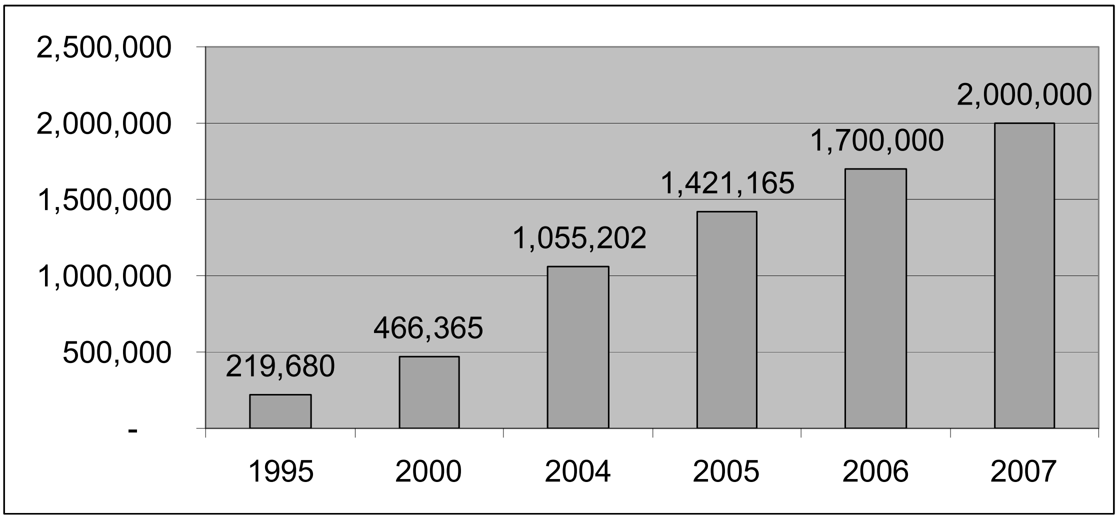
(*i*) *Potential in Agriculture*

Cambodia's economy is based on agriculture. About 85 percent of its population is dependent on agriculture, which has not been modernized yet. It depends almost completely on natural condition yet the country can still sustain food sufficiency and surplus for export. At present, the agriculture sector, which is the backbone of the Cambodian economy, has been opened for FDI. Therefore, agricultural development is a big potential for future development. Transfer of technology in agriculture will follow the flow of FDI and will contribute to agricultural modernization. With the low cost of labor, agriculture has a huge potential for attracting foreign investments into Cambodia.

(*ii*) *Potential in Tourism*

Located in Southeast Asia, where tourism is booming especially in countries like Thailand, Malaysia, and Singapore, Cambodia can catch this opportunity in tourism development by using Bangkok, Kuala Lumpur, and Singapore as regional hubs. Cambodia has an advantage in international tourism because of its historical heritage, unpolluted scenic attractions, and central location in Southeast Asia. Cambodia, the successor of the Khmer Empire and Khmer civilization, had a great influence on the cultural and artistic evolution of the region. The Angkor Temple Complex, represented

Figure 5: Tourist arrivals 1995- 2007



Source: Ministry of Tourism

by Angkor Wat and Angkor Tom, is one of the most significant cultural heritages in the world and is promising enough to develop as an international tourist destination. Other than historical heritage, the rural landscape is also an important attraction for tourists in Cambodia. The Mekong River, the Tonle Sap Lake, and the beautiful beaches in Sihanoukville and Kompot province will also attract nature tourists. Furthermore, Phnom Penh, the capital of Cambodia, is an international gateway and its French-influenced atmosphere will be enhanced for tourists after renovation of buildings and streets. Major tourist attractions in the city are the Royal Palace, the National Museum, the view of the Mekong River, and the areas surrounding with mountains, forests, lakes, and streams. The government has concentrated on three poles of tourism development (Phnom Penh, Siem Reap, Sihanoukville) by inviting national and international investment companies to develop tourism through the construction of hotels and tourist sites following international standards. This indicates that tourism is the most attractive sector for investment. At present, it can be the backbone of the economy instead of agriculture. Tourist arrivals have increased year by year with an average of about 20 percent annually from only 118,228 in 1993 to 604,919 tourists in 2001, 1,055,202 in 2004, 1,700,000 in 2006, and about 2 million in 2007 (See figure 5).

(*iii*) *Potential in Natural Resources*

Cambodia will build on its comparative advantage by developing natural-resource-based industries of different kinds, including agro-based, wood-based, fisheries-based, and industry-based (nonmetallic mineral resources). This is a big potential for attracting foreign investment. If Cambodia is successful in expanding rice production to the point where it is exporting significant quantities of rice, this will itself create employment and value added in processing. Other possibilities in agro-processing include sugar and vegetable oil processing. Products and animal feed production will need to be given more systematic economic evaluation. Moreover, the widespread rural small-scale manufacture of tobacco products suggests that further scope exists for large-scale production, yielding higher quality product and higher value added.

Oil and gas exploration recommenced in Cambodia in 1991, following earlier efforts in 1969-74, and has already produced very promising results. Altogether, 16,000 line kilometers of high-quality seismic data have been obtained, giving good geological information, which indicates the potential for substantial oil and gas generation (Royal Government of Cambodia 1997, p.156).

For the purpose of exploration, both land and sea areas of Cambodian territory have been divided into blocks, 32 altogether, of which the offshore blocks I-IV have so far been explored. Three major oil companies, with 30-year contracts, have been engaged in drilling. Positive results from drilling in Block III in late 1993 were followed by the most successful test so far, carried out in Block I and Block III in late 1993 were followed by the most successful tests so far, carried out in Block I and Block II in the first part of 1994, which produced a maximum flow rate of 4.7 m cubic feet of gas and 180 barrels of condensate per day. Another company testing in Block IV in the same year produced a maximum flow rate of 1.3 m cubic feet of gas and 1,180 barrels of oil per day (Royal Government of Cambodia 1997, p.156).,

The government now plans to offer further acreage for licensing. The licensing regime embraces royalties and a tax system, controlled by production-sharing contracts, which provide attractive terms for exploration and production projects. The successful development of oil and gas production could do much to transform Cambodia's economic situation by providing current revenues to cover the recurrent costs of social and economic development programs—the costs of which at present constitute a severe constraint—and the heavy funding required for new infrastructure development.

Although Cambodia has good mineral resources potential, events of the last two decades have prevented the development of the mineral sector. This has been compounded by factors such as scarcity of capital, high costs of exploration and exploitation, lack of expertise, and absence of effective mining laws and regulations. Potential exists with respect to gold, gemstones (ruby, sapphire, zircon), phosphates (for fertilizer), limestone (for cement and building stone), bauxite, clay, sand/gravel, and granite, with the first two as commercially most promising. Copper and zinc also exist but require more exploration work. Exploration for gold by three companies has been initiated.

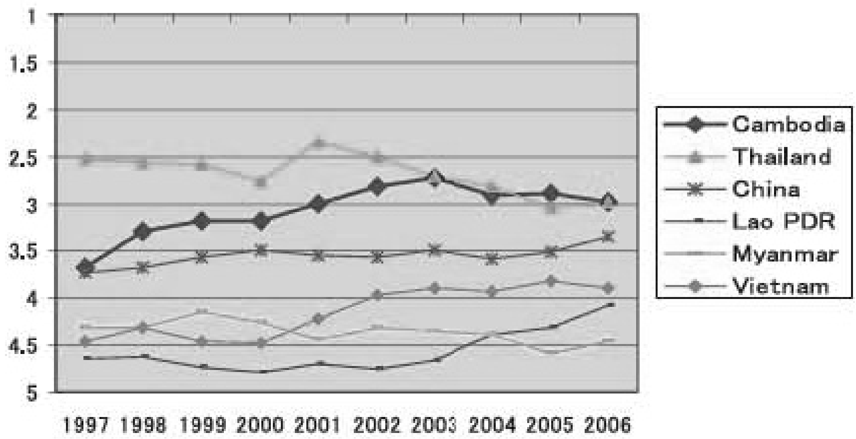
Mitsubishi Corporation and BHP Billiton have signed a mineral exploration agreement with the Royal Government of Cambodia to explore for bauxite and to evaluate the potential for an alumina refinery. The agreement requires a detailed evaluation of the Mondolkiri exploration licences in Eastern Cambodia to determine resource size and quality, environmental and community issues, risks from unexploded ordinances, and the appropriate mining, processing, and transport options. Following studies due in the first half of 2008, the partners have the exclusive rights to negotiate a mining agreement with the government to develop the project. BHP Billiotn and Mitsubishi Corp previously partnered on the Mozal aluminium smelter in Mozambique (Japan's Corporate News Network, Tokyo, 11 October 2006 at http://www.japancorp.net/Article.Asp?Art_ID=13537, accessed on 6 January 2008).

As in the case of oil, the government is in the process of developing national policy guidelines, legislations, and regulations for mining exploration and exploitation designed to provide incentives and protection to investors while also ensuring protection of the environment. Once the details are clarified, a new Mining Law will be prepared and submitted to the National Assembly for Adoption.

(2) Economic Freedom

Cambodia is classified as one of the most liberal economies in economic freedom. According to the "2006 Index of Economic Freedom" by the Heritage Foundation in the US, Cambodia ranked 9th out of 32 countries and regions in Asia in terms of absence of government coercion or constraint on economic activities. Among ASEAN countries, only Singapore is above Cambodia. Cambodia is categorized as "Most Free," in which Japan, Taiwan, and South Korea are included as well. In the last 10 years to 2006, Cambodia's index has improved, although it has been relatively flat over the last three years. The improvement in Cambodia's index is very obvious in contrast to Thailand, as shown in Figure 6 and Box 1.

Figure 6: Comparison of Index of Economic Freedom in selected countries



Source: 2005 Index of Economic Freedom by Heritage Foundation/ Wall Street Journal.

Box 1: Cambodia ranks 63 out of 161 countries (2005)

Category: Mostly Free

Score: 1- 5

- Trade policy : 4 (high level of protectionism)
- Fiscal Burden: 2,4 (lost cost of government)
- Government intervention in the economy : 2,5 (moderate level)
- Monetary policy : 1 (very low level of inflation)
- FDI : 3 (moderate barriers)
- Banking and Finance : 2 (low level of restriction)
- Wages and Finance : 2 (low level of intervention)
- Property rights : 4 (low level of protection)
- Regulation : 4 (high level)
- Informal market: 4 (high level of activity)

Source: 2005 Index of Economic Freedom by Heritage Foundation/ Wall Street Journal.

(3) Competitiveness

A study titled "Cambodia Competitiveness Report" has sought to conduct a comprehensive assessment of the country's competitiveness through the observations of top business executives on various aspects of Cambodia's economic environment, in order to eventually aggregate and analyze their perceptions on issues related to national competitiveness. The report contains three basic sets of findings. First, it details outcomes of an executive opinion survey conducted among leading business executives in Cambodia. Second, it deals with the Growth Competitiveness Index (GCI) of the World Economic Forum (WEF) in which Cambodia is compared to its competitors.

Third, Cambodia's performance is assessed within the framework of the Business Competitiveness Index of Michael E Porter (Economic Institute of Cambodia 2005).

The WEF views national competitiveness as a set of factors, policies, and institutions that determine the level of productivity of a country. Raising productivity is, according to WEF, the driving force behind the rates of return on investment, which, in turn, determine the aggregate growth rates of an economy. This means that a more competitive economy will be one that will grow faster in a medium to long-term perspective. Based on this perspective, the WEF defines three stages of economic development: factor-driven stage, efficiency-driven stage, and innovation-driven stage. With GDP per capita of about US$500, Cambodia is undoubtedly treated as a factor-driven economy that competes based on factor endowments, primarily unskilled labor and natural resources. According to the above study, Cambodia remains among the least competitive countries in the world. This year's ranking, the WEF's GCI 2006-2007, places Cambodia at 103rd among 125 countries in the assessment. The country's performance is slightly behind Bangladesh (99), but lags far beyond its neighboring countries such as Thailand (35), Indonesia (50), China (54), and Vietnam (77). Switzerland is the world's most competitive country, while Angola is at the bottom of the WEF's GCI 2006-2007 (Economic Institute of Cambodia 2006).

However, the above study was not positively received by the Government as it is said to be creating a negative image for the country. The Government reasoned that the study is giving an inaccurate picture of Cambodia because in reality, there are booming businesses by local and foreign investors and business persons, especially in the construction and services sectors, and more increasing inflow of FDI to Cambodia, especially from China, Korea, and other countries in the region.

(4) Credit Rating

For the first time in history, the Royal Government of Cambodia assigned the Credit Suisse to act as its rating advisor in coordinating a sovereign credit rating. Cambodia has secured a B+ rating for long-term foreign and local currency government bonds from Standard & Poor's and B2 ratings for foreign currency and local currency government bonds from Moody's. The outlook for all ratings is stable. According to Agost Bernad, Standard & Poor's primary credit analyst:

> *"Real GDP growth averaging 9% over the past six years boosted per-capita GDP by 64%. There is reason to expect similar robust growth performance in the medium term, given the policy continuity, which focuses on export-led growth and stability in price and exchange rates."*

Meanwhile, Standard & Poor's recognized Cambodia's track record of strong economic growth and the underlying prudent macroeconomic policy mix, as well as the ongoing donor engagement that provides a policy anchor and underpins domestic and external liquidity. Moody's Vice President Thomas Byrne notes:

> *"Cambodia has recently attracted significant inflows of foreign direct investment into sectors such as tourism, garments and energy, which should*

> *help to continue to boost the overall level of investment in the economy as well as to strengthen the balance of payments"* (Government and Credit Suisse Press Release, May 2007).

According to its press release, Moody's acknowledged that such inflows, coupled with steady disbursements of concessional official development assistance, have offset current account deficits and have contributed to a build-up in official foreign exchange reserves to a level that is adequate in relation to the country's near-term debt repayments, thereby providing some buffer to external shocks. Moody's expects that improved competitiveness in the garment sector, continued growth in tourism, and a timely, well-managed development of Cambodia's relatively large proven reserves of oil and gas would strengthen the fiscal and external payment positions of Cambodia. Moody's also gave credit to Cambodia's stable political system and noted that continued institutional improvement should improve the country's investment climate and thereby boost long-term economic growth.

Standard & Poor's assigned a short-term foreign and local currency rating of B. Moody's also assigned a foreign currency bond ceiling of B1, a foreign-currency ceiling for bank deposits of B3, a local currency bond ceiling and a local currency deposit ceiling of Ba1.

This positive rating has opened the way for Government in issuing commercial bonds both in local and foreign currency to mobilize money in financing government projects in addition to the bilateral and concession loan that is tied to many conditions.

It has also helped in improving investor confidence in Cambodia and in showing Cambodia's financial health.

5. CHALLENGES

(1) Poverty

Though the decline in poverty has been significant and widespread due to the rise in average per capita consumption, Cambodia is still facing a major challenge in having a high poverty rate. Within the geographical sampling of the first survey, the headcount fell from 39 to 28 percent. Backward projection based on this observed trend suggests that the national poverty rate fell by 10-15 percent over the last decade (from 45-50 percent in 1993/4 to 35 percent in 2004). Moreover, poverty is very likely to have fallen further in 2005 and 2006 due to the exceptionally high growth rates in those years, especially in agriculture. Projections put the poverty rate at about 32.5 percent in 2006 (Hang 2007, p. 2).

(2) Inequality

Cambodia is facing a growing tendency to exacerbate the inequality between the rich and the poor, and aggravate the regional disparity between urban and rural areas. Due to lack of social safety net and protection, the poor are very vulnerable to fall into a higher poverty status. Among the areas, Phnom Penh is the fastest developing urban area due to the availability of infrastructure and public utilities, and land concentration.

(3) Insufficient Infrastructure

Due to a long protracted war, international isolation, and political strife, the infrastructure in Cambodia is still in poor condition compared to other countries in the region. At present, Cambodia does not have sufficient financial, technical, and human resources that are necessary for infrastructure construction. Inadequate physical infrastructure, including road transportation, electricity, irrigation and water systems, and port facilities, is a major barrier to economic development and poverty reduction in Cambodia. Hence, infrastructure networks can be assigned a leading role in supporting the development process. Overcoming this bottleneck involves considerable investment, capacity building, new policies, and institutional reform.

(4) Land Dispute

Though Cambodia has a low density of population per land compared to many countries in the region, land becomes scarce as the demand for investment and agriculture increasingly rise. Because land is more expensive due to robust economic development, land possession is the most difficult problem. The poor and the farmers are vulnerable to the problem of "landlessness" because they sell their land to solve urgent problems such as paying off debts and paying health and medical care. Land grabbing by the powerful and the rich and granting of economic concessions for investors' plantation and logging also often lead to land disputes and violence at times.

(5) Lack of Information and Understanding on Economic Integration

Except for foreign investment firms, Cambodian enterprises, especially small and medium enterprises (SMEs), experience many difficulties in entering export markets and in expanding exports. Familiarity with modern data and information sources is low and sometimes nonexistent. As a result, SMEs are not aware of the design and quality requirements of foreign markets. The private sector also has little or no idea about the benefits of economic integration. There is also limited support from the Cambodian government to keep the private sector informed on commodity prices and market access. This lack of knowledge results in missed opportunities for Cambodia to exploit the export markets under the AFTA and other free trade arrangements.

(6) Lack of Trade Promotion Activities

Cambodia has very limited funds for conducting activities in promoting trade abroad. Unlike Thailand, Vietnam, China, Korea, Taiwan, and other countries in the region, Cambodia seldom conducts trade fairs and trade promotion events except when the country is provided free space during international conventions or exhibitions abroad. The role of Cambodian embassies abroad for trade promotion is also very limited.

In conducting international business, especially trading, activities such as promotion, marketing, and finding appropriate business partners are essential. Cambodian producers and traders have difficulty in exploring trading opportunities because they lack experience in dealing with the international market. Foreign producers and traders have an edge because they receive strong support from the Government through trade fairs and other trade promotion activities.

(7) Complicated Bureaucracy for Trade in Cambodia

Though the market is available for the country in the framework of AFTA, Cambodia is beset by domestic problems especially in dealing with complicated procedures and corrupt practices in exporting products. Fisheries, rice, and other agro-products still require various permits (transportation permits, export permits, etc.). Firms frequently face delays in clearing imported inputs through customs, thereby jeopardizing their production schedule and ability to meet the delivery dates required by their clients abroad.

(8) High Cost of Doing Business in Cambodia

As the country is in transition, corruption in the administration (and particularly in business operation including import-export activities) is a serious problem. Local business people have identified other problems such as lack of infrastructure; protracted customs clearance procedure; high cost of electricity, internet, and telephone; and high cost of transportation. Phnom Penh and many other major cities often face electricity blackout due to inadequate supply or unreliable source of electricity.

(9) Low Production Base

Economy of scale is very favorable for trading, especially for agricultural products. However, most of Cambodia's agricultural products are small-size family ventures that are not appropriate for export as some importers require big volume of products. Intermediate traders (or middlemen) usually exploit the market and extort price that may lead to losses in revenue for smallholders. On the other hand, most of Cambodia's agricultural products are available only seasonally and not all-year round. For example, rice in Cambodia can be harvested only once a year between November and January. It is difficult to supply rice to the market all-year round unless Cambodia has a good technology in postharvest storage and quality control.

(10) Poor Technology

Cambodia has limited production bases, especially the processing industry. With limited support from the State and poor status of human resource, Cambodian farmers and producers depend primarily on traditional style of production. Thus, with poor technology, productivity is low compared to competing countries, resulting in huge losses for Cambodia in the global competition.

(11) Lack of Credit Access and Insurance

To promote commercialization of Cambodia's agro-products, financial resources are required to invest on land, fertilizers, machineries, transport and marketing of produce, insurance, hiring of labor, etc. At present, farmers and producers are in dire need of credit for business start-up or expansion. However, they cannot get a loan without condition or collateral, which is normally required by commercial banks. International trade finance activities carried out by banks in Cambodia also tend to be limited to payments and collections and letters of credit. Pre-and post-shipment finance is not easily available from banks in Cambodia. Insurance is also not well developed. Factories and the transport of merchandise within Cambodia are rarely insured.

6. CONCLUSION

Cambodia has conducted many economic reforms to promote economic growth and reduce poverty. Though the country has been admitted to most of the regional cooperation mechanisms such as ASEAN, AFTA, and WTO, the benefits of market access are still limited and thus, it is still premature to evaluate the costs and benefits. The country is still facing many constraints in the process of economic development such as high poverty rate, growing inequality, insufficient infrastructure, and low production base. Private sector participation in trade to benefit from AFTA and ASEAN+3 (such as the ASEAN-China FTA) is very limited. There are many constraints to overcome this shortcoming.

Cambodia has few finished products that are usually in poor quality so they cannot compete with similar products imported from neighboring countries. Though the trade volume has increased yearly, the trade deficit keeps on growing. With its active participation in trade promotion activities such as the World Expo and China-ASEAN Expo, Cambodia can promote its products internationally. Examples are Muscle Wine, palm wine and Angkor Beer, which Cambodia can promote to huge markets like Japan and France. Other promising export products are handicrafts, rice, fish, rubber, and wood.

Cambodia has no other viable alternative to realize ASEAN integration but to effectively address the imbalanced development in the region on the one hand, and move ahead toward enhancing and deepening East Asian cooperation, on the other hand.

The disparity in ASEAN today constitutes a real major challenge, which the member countries must overcome at any cost. A fully integrated ASEAN will sustain its relevance, boost its competitiveness in the face of increasing challenges of globalization and regionalization, and revive its strength as a catalyst for strengthening East Asia. Moreover, an economically strong ASEAN will not only benefit ASEAN but also its partners. Therefore, the integration of ASEAN remains a critical factor that will bestow significant benefits to East Asia as a whole and to ASEAN's other partners as well.

7. POLICY RECOMMENDATION

(1) Tax on Assets

In Cambodia, the revenue from tax collection is still very low compared to other countries in the region. One of the major reasons is because the government does not impose tax on property and land as this is a sensitive political issue in Cambodia. At present, the price of land and real estate is skyrocketing in Cambodia, especially in urban areas like Phnom Penh, Sihanoukville, and Siem Reap. However, the government has not tapped the benefit from the rising land price and booming real estate businesses. Though there is a small tax (seal tax) on land title transfer, the agreement on sales without transfer of land title may lead to huge losses from tax evasion throughout the country. Therefore, land tax, especially on unused land, should be strongly recommended even at a low rate. This will generate revenue for the local and central governments and will reduce land speculation as well.

(2) Enhancing Agricultural Productivity

The government should implement agriculture-led strategies to achieve accelerated progress in quantity and quality. Growth in the agricultural sector can result from increased production through higher productivity, containment of losses (which, at present, could be as high as 35-40 percent), sound postharvest support systems, crop diversification (including horticulture and floriculture), and increased emphasis on animal husbandry and fisheries. The concept of "Green Belt" should be promoted for booming urban areas.

(3) Promotion of Infrastructure Linkages to Countries in the Region

The focus for transport infrastructure for the rehabilitation of high-priority trunk and feeder roads and bridges, especially the regional highways linking countries in the region, should remain to realize the potential of agriculture, tourism, and trade in the rural areas. There is also a need to develop a comprehensive transport policy framework, addressing issues such as development of a balanced construction and maintenance program, increased involvement of the private sector, and financing of road maintenance and cost recovery mechanisms. With regard to institutional strengthening, the Ministry of Public Works and Transport will formulate strategies to improve its capacity to plan, manage, and implement road operations.

Major investments are now being made to improve the physical transport infrastructure linking Cambodia with Thailand and Vietnam, as well as to improve sea and air access to international destinations, especially China. Energy, port, and airport should be promoted to meet the increasing demand of production and trade. These developments could greatly reduce transport costs and increase the competitiveness of Cambodian products on export markets. However, the full benefits of such developments will only be realized if people and goods can move across borders at minimal cost.

(4) Investment Promotion

Cambodia is one of the most attractive destinations of FDI in the region due to its abundant natural resources, low labor cost, and liberal laws. There is a huge potential for Cambodia to attract FDI from rich countries. Investment promotion should be organized locally and abroad. In-country campaigns should include seminars and debriefings to business communities and foreign diplomats to familiarize them with the legal and institutional framework, investment incentives, and investment opportunities. The products and services of the CDC should be promoted to satisfy investors. Successful cases should be documented and featured in promotional instruments like leaflets, brochures, and investment guides.

Campaigns for investment promotion abroad may include sending investment promotion missions, participating in regional fora and seminars, networking through Cambodia’s embassies abroad or the ASEAN business centers as channel of communication, and setting up information service centers. Trade fairs promoting Cambodia’s products and services will also help attract foreign investment.

As the Government decentralized to the provincial and municipal levels the decision on project investments amounting to less than US$2 million, investment promotion should be conducted at the provincial level as well to present the investment opportunities in the area. The CDC should invite the provincial investment promotion agencies to participate in campaigns to attract investment and technology transfer.

(5) Urbanization and Zoning

Huge regional disparity exists in Cambodia. It is therefore important to promote the regional growth corridors, such as Phnom Penh, Siem Reap, Sihanoukville, and the Northeastern region. The most crowded areas are the plain plateau and along the Mekong River, where soil condition is favorable for agriculture. The least crowded is the coastal area. Most economic activities concentrate only in Phnom Penh and a few other urban areas such as Siem Reap and Sihanoukville. The government should develop an appropriate urbanization plan by assigning growth corridors to spread development benefits to other regions and down to the provinces and districts.

Autonomous regions or cities such as Poi Pet, Kep, Pailin, Sihanoukville, Neak Leung, Soung, Steng Treng, and other strategic locations should be developed as FDI destinations by building the necessary infrastructure and facilities. Special economic zones (export processing zone, free trade zone) should be put in place by government and the privates sector to attract investment and promote equitable economic development in these cities.

(6) Trade Facilitation

The Government should play an active role in supporting farmers by providing standard certificate, credit access, and market information. The role of the Government in trade promotion and trade support services is in its infancy. At present, the Government does not effectively promote trade or provide trade support services. Although the Ministry of Commerce has recently established a trade promotion department, it is not yet fully operational due to lack of funding. Developing effective mechanisms such as, for example, training officials for effective trade promotion and trade support services is clearly an area that is greatly needed by Cambodia. Thus far, the Phnom Penh Chamber of Commerce has not actively promoted trade among its members or the Cambodian private sector at large.

Assistance is needed in all aspects of creating an effective export promotion mechanism, including the elaboration of an export promotion strategy, developing and managing the necessary national and international databases, and training trade officials and staff on techniques for organizing trade fairs and other trade promotion activities. Promoting the exports of SMEs should also be given attention.

Assistance is also required in completing the task of putting in place an appropriate legal and regulatory framework for the financial sector. Training on trade finance and trade insurance is required for both the private sector and government officials (in particular those dealing with export promotion). Help is needed in setting up proper mechanisms to supervise the implementation of the forthcoming legislation on insurance.

In the area of business information, training on international marketing is required for those involved in export promotion and for private traders associations as well.

Assistance is also needed in establishing a “trade point” to facilitate the exchange of information needed by exporters and importers. Assistance is required in putting in place more effective customs procedures, allowing Cambodia to benefit fully from customs automation through the Automated System for Customs Data. In addition to allowing more efficient customs clearance for traders, automation will enhance the capacity of the customs department to generate timely trade data, and improve revenue collection.

Export credit and investment insurance agencies, commonly known as ECAs, play a critical role in international trade and finance in developing countries, and thus have a great impact on sustainable development. ECAs provide government-backed loans, guarantees, and insurance to corporations seeking business opportunities in developing countries and emerging markets that are often considered too risky for conventional corporate financing. They are primarily public or publicly mandated institutions that support and subsidize exports and investment of companies from their home country. Cambodia should recognize ECA as part of trade facilitation. (For more details about the ECA, see Center for International Environmental Law 2002.)

(7) Access to Market Information

Information gathering and dissemination on trade, agro-business, and potential markets should be strengthened as this will be useful for the business community in analyzing trading potentials. The government should establish information broadcasting through TV or radio and encourage the people to use the internet and other information communication technologies (ICTs) by reducing internet fee and other means.

(8) Technology Transfer

Cambodia cannot move fast enough to catch up with its neighbors in the region if the level of technology and science will remain low. Technology transfer should fit the overall strategy of the government's priority. Investment encouragement to succeed would have to take emphasis on job creation, research and development (R&D), and effective knowledge and technology transfer.

The government may wish to consider the following measures:

- Ensure assessment of local needs in technology as well as the social impacts of technology
- Expand R&D programs in technology development including adaptation to local needs
- Create awareness on technology transfer
- Improve transfer of technology among developing countries including joint R&D and opening of markets
- Develop the ICT infrastructure to support investments in technology and the operation of intermediaries
- Establish high-tech parks to attract investment in high technology such as electronics and computer parts.
- Improve macroeconomic stability for transfer of technology

To maximize the benefits of FDI through enhancing technology transfers and spillovers, Cambodia should make sure that interventions based on anticipated trends of comparative advantage will be effective, but this would require careful industry-specific analysis and broad-based consultation with the private sector and other stakeholders. Cambodia should rely more on comparative advantage, and keep in mind that FDI that responds to global market forces holds promise, particularly FDI in export sectors.

(9) Industry Diversification and SMEs

So far, Cambodia depends mainly on the garment and apparel industry, tourism, and agriculture. Diversification of industry and promotion of SMEs are very important to promote local production. National standard for local products must be strengthened to meet international benchmark, especially for food and processed products.

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Chapter 11

CHALLENGES, PROSPECTS AND STRATEGIES FOR CLMV DEVELOPMENT: THE CASE OF LAO PDR

Leeber Leebouapao

ABSTRACT

Within the context of regional economic integration, Lao PDR is facing numerous challenges for being one of the least developed countries (LDC) in the world. Hence, the Lao Government has called for a long-term socioeconomic development strategy with the goal of graduating from the LDC status by 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 Six National Development Plan(2006-2010), the National Growth and Poverty Eradication Strategy(NGPES), and the sectoral long-term development strategy. However, to implement the Government's development strategy framework more successfully and narrow the gap of the country's development in the region, some policy recommendations from a research perspective should be taken into account, namely: 1) Infrastructure development by focusing on land-linked country and economic corridors; 2) Strengthening private sector development by promoting SME development and market development (financial market development, labour market development, real estate market development); 3) Tourism development by promoting cultural, eco-based, and historical tourism in the country as a sustainable tourist-friendly destination; 4) Keeping a natural resource-based industry that is both environmental friendly and economically efficient; 5) Developing the processing industry in the country for export and domestic consumption; and 6) Human resource development with focus on vocational schools and training for skilled labour.

1. INTRODUCTION

This paper, which is under the ERIA research project on CLMV, discusses the Lao Government's development strategy and the author's recommendations from a research point of view. The paper is broken down into four main parts. Part I provides an assessment of recent development performance. It gives an overview of the Lao economy, overall achievements at the macroeconomic and sectoral levels, and some lessons learned. Part II identifies some of the main challenges and constraints to economic development. Part III focuses on the development strategy perspective for the Lao PDR. It examines the potentials and opportunities for development and reviews the Government's development strategy framework. Part IV gives some policy recommendations for promoting sustainable growth in the Lao PDR.

2. RECENT DEVELOPMENT PERFORMANCE

2.1 Context

From mid-1997 to the end of 1999, the economy of the Lao PDR faced arduous difficulties, especially the significant negative impacts of the Asian economic crisis and recurring severe natural disasters. However, since 2001, the Lao economy has recovered and developed under more favourable conditions. The economy has begun to resume expansion and build up the potential for growing at a faster pace in the following years. Production forces and socioeconomic elements have built the necessary initial base for future growth. The legal frameworks were gradually adjusted and their positive impacts on socioeconomic development have since increased. The market-oriented economy emerged further and operated in a more efficient manner. Political and social stability were enhanced. Relations with countries in the region and outside on economic and other fronts were expanded, with significant strengthening of the capacity and standing of the Lao PDR in the region and the global community. The developments outside the country also significantly provided favourable conditions. Stability and economic recovery in the Asian region and at the global level, scientific and technological innovations, and globalization brought about many opportunities to overcome the difficulties and obstacles.

Meanwhile, the global situation developed in a complex manner after the 11th September 2001 event in the United States and the Afghanistan and Iraq wars that followed. Terrorism and antiterrorism became dominant issues, but peace and development cooperation remained major priorities at the international level. The global and regional economies have been recovering, with firm continuation of globalization and increasing competition. Within Southeast Asia, SARS, Avian Flu, and floods and droughts have occurred. These developments have imposed severe difficulties on the Lao social and economic bases.

2.2 Economic Growth

During the five-year period (2001-2005), the Lao economy has maintained rapid and sustainable growth. On average, the GDP grew at about 6.24 percent per annum, which is about 0.3 percentage point higher than the average growth rate in the previous five-year period (1996-2000). The growth rate failed to reach the target set in the Government's Plan and the full potential of the economy was not utilized. However, it is heartening to note that the growth rate achieved is higher than that recorded in the previous Plan period (1996-2000). It is also useful to highlight the relative growth rates of the domestic private sector output, output from foreign direct investment (FDI) enterprises, and State output. The average economic growth rate in the Lao PDR during the past five years is among the highest in the region (e.g., Cambodia, 5.5%; Indonesia, 4.2%; Malaysia, 4.3%; Philippines, 4.2%; Singapore, 3.7%; Thailand, 4%; Hong Kong, 2.8%; South Korea, 4.7%; Taiwan, 4.2%; Viet Nam, 7.5%). By 2005, the GDP per capita reached US$491.

2.3 Sectoral Performance

All the economic sectors experienced growth, which has been linked to structural changes and the enhancement of product quality. The sectoral performance is presented in the following:

2.3.1 Agriculture Sector

During the past five years, the Government, line ministries, and sectoral and local authorities of the Lao PDR have concentrated on the development of agricultural production, following the direction set, i.e., orienting the agriculture sector from subsistence and semisubsistence to commercial production to ensure the enhanced supply of raw materials to processing industries, meeting the growing domestic requirements for agricultural products, and rapidly expanding agricultural exports. The composition of production and products has been restructured positively with increasing economic effectiveness. This therefore allowed a stable growth in agriculture, forestry, and fisheries production, albeit under constrained development conditions. Over the last five years, the value of production in the agriculture sector has increased on average by 3.4 percent per year.

By 2005, the production of many crops increased significantly compared to the last year of the fourth five-year Plan (2000). For example, maize (corn) production tripled to 372,560 mt as compared to that in 2000. Maize is grown largely in the northern provinces, such as Bokeo, Sayaboury, Houaphanh, and Xiengkhouang, and in some central provinces. The production of coffee, which is concentrated in the provinces of Champasack, Saravane, and Sekong, increased by six percent reaching 25,000 tons. Peanut production, largely found in the provinces of Sayaboury, Luang Prabang, Vientiane, Saravane, and Champasack, doubled to 26,990 tons. Soybean production, which is concentrated in the provinces of Luang Prabang, Bokeo, Houaphanh, and Champasak, also experienced a two-fold increase to 11,100 tons. Sesame plantation yielded 8,710 tons, up by 2.6 times, and was largely found in the provinces of Luang Prabang, Sayaboury, Oudomsay, and Vientiane. Mungbean production was up by three times to 3,700 tons, and was concentrated in the provinces of Luang Prabang, Vientiane, and Champasak. Tobacco planted in the provinces of Borikhamsay, Khammouane, and Savannakhet provided a total harvest of 28,100 tons. Sugarcane, which is concentrated in Vientiane Capital and in the provinces of Luang Namtha, Phongsaly, and Borikhamsay, had a harvest of 196,100 tons. Vegetable production increased by 17 percent to 744,450 tons. Most noticeable are the plantations of vegetables, such as cabbage, Chinese cabbage, bananas, potatoes, and ginger, on the Boloven Plateau for export. Having won popularity, rubber trees are extensively planted in the provinces of Luang Namtha, Oudomsay, Bokeo, Khammouane, Champasak, Saravane, Sekong, and Attapeu. Orchards are being grown in a number of provinces, particularly orange plantations in Luang Prabang, Sayaboury, Borikhamsay, Vientiane, and Vientiane Capital.

The move to commercial production is growing strongly in the high-potential areas. Prominent among these are the emphasis on the cultivation of rubber in Luang Namtha; cashew nuts in Oudomxay and Phongsaly; corn, vegetables, and fruit trees in Vientiane Province and Vientiane Capital; seeded trees for oil extraction and sugarcane in Savannakhet; and rice in Vientiane Province.

Emphasis is placed on research and the adoption of high-yield/high-productivity crops and livestock. Currently, several new varieties have been introduced, such as rice, maize, vegetables, beans, coffee, tobacco, tea, and fruit trees, as well as a number of domestic animals. By 2005, the farming sector ensured 80 percent of the seed requirements for the rainy season crop and 100 percent for the dry season crop. Many modern cultivation and animal raising techniques have been introduced.

The number of irrigation schemes has continued to increase from 19,170 in 2000 to 24,695 by the end of 2004. Irrigated crop areas during the dry season increased from 197,100 ha in 2000 to 215,000 ha in 2004, while the irrigated area during the rainy season increased from 296,000 ha to 315,000 ha. Due to the increase in irrigation and the introduction of new crop varieties, rice yield increased from less than 3.06 mt per hectare in 2000 to 3.6 mt per hectare in 2005. Rice production reached 2.65 million mt in 2005, which translates to an average per capita availability of approximately 457 kg per capita.

The livestock and fisheries sectors are developing quite rapidly mainly due to the industrial farming systems applied in many localities and because of increased market opportunities and reductions in marketing costs. In 2005, the livestock numbers rose to 1.09 million buffalos (6% increase over 2000), 1.27 million cows (15.6% increase), 1.82 million pigs (28% increase), 19.8 million poultry (51% increase), and 190,000 goats and sheep (56% increase).

Thanks to such rapid development, meat production in 2005 was projected to reach 96,000 mt (an increase of 17.5% over 2000). It is notable that about 10.2 percent of the meat production is provided by industrial farms with high technology, which grew at the rate of 9.8 percent in the 2003-2004 period. At the end of 2005, about 10 percent of the cattle and 20 percent of the poultry were raised in the commercial farms. More specifically, the farms have focused on raising new high-quality cattle and poultry species, with high productivity in the production of swine, chicken, and ducks.

Also, fish production rose to 143,000 mt (an increase of 15%), with fish farms accounting for 68.5 percent of the total and capture fisheries accounting for the rest (31.5%). Fish fingerling production rose to 320 million, which was adequate to meet about 50 percent of the national demand. Fish farms have achieved high productivity in the production of fish raised in baskets. In 2005, both meat and fish production met a large part of the population's consumption demands.

Forest conservation and development are given increased attention by line ministries and local authorities compared to the previous plans. The forestation movement by the people has regained momentum, especially in the central provinces, such as Vientiane, Borikhamxay, Khammuane, and Savannakhet,

More specifically, many areas have combined forestation with the development of high-commercial-value industrial trees, such as teak in the provinces of Luang Prabang, Sayaboury, Vientiane, Bokeo, Champasak, Bolikhamxay, and Attapeu, and rubber in the provinces of Luang Namtha, Khammouane, Champasack, Saravane, Sekong, Attapeu, Bokeo, and Oudomxay.

Between 2001 and 2005, about 325 tree nurseries were set up for the germination of tree saplings for afforestation and forest restoration. About 240,000 kg of tree seeds were used for the production of some 119 million tree saplings. During 2001-2005, afforestation covered 91,000 ha, accounting for 91 percent of the target (100,000 ha) while efforts were made on forest restoration on 481,000 ha.

According to data on forest exploration in 2002, the area of dense forest, which included forests of high and medium density with a canopy of over 20 percent, accounted for 41.5 percent (9,724,700 ha) of the country's total land surface. If the brushwood, bamboo forests, degraded forests, and mixed deciduous forests with a canopy of less than 20 percent were combined with the dense forests, the forestry coverage accounted for 72 percent (17 million ha) of the country's land surface.

The exploitation of perennial trees has reduced significantly in the last five years. In 2001, about 300,000 cubic meters of natural trees were exploited, which declined to 150,000 cubic meters in 2005. Wood exploitation is currently subject to more careful consideration (e.g., combining exploitation with the plantation of alternative trees).

In the past five years, over 1.09 million ha of arable land and 3.6 million ha of forestry land were allocated to 7,125 villages composed of 419,250 households, to reduce the practice of shifting cultivation while ensuring sedentary highland and lowland cultivation to reduce poverty among the ethnic people. As a result, the area under shifting cultivation declined from 118,900 ha in 2001 to 29,400 ha in 2005, mainly in the northern provinces (26,800 ha), with the remainder in the central region (2,600 ha). Shifting cultivation has ceased completely in the southern provinces. The number of farm families practicing shifting cultivation has reduced from 174,036 in 2000 to 32,790 in 2005.

The development of agricultural and rural economies has begun to diversify. A large number of farms have been established and the production of traditional handicrafts has been resumed. The development of traditional handicrafts has generated additional jobs for the local people and contributed to the changes in the rural economic structure as well as the improvement of the population's living conditions. The government has removed barriers to private sector investment and trade in the agricultural sector. At the same time, it has increased the population's purchasing power and contributed to the eradication of poverty in rural areas.

2.3.2 Industry and Construction Sector

Industrial production has grown at a steady and rapid rate, with the sector-wide average growth reaching 11.3 percent per year, exceeding the Plan target of 10-11 percent. The mining industry increased by 33.87 percent; food processing, 9.17 percent; tobacco, 20.75 percent; textiles, 20.11 percent; garments, 11.15 percent; footwear, 7.57 percent; and wood processing, 1.17 percent. The sectors receiving foreign investment have achieved an impressively rapid growth, followed by the nonstate sector, with the domestic private sector growing slowly. In the past five years, the industrial sector has implemented several significant activities, such as the exploitation of gold and copper at Sepon; zinc in Vientiane Province; construction of a cement plant in Vangvieng and a steel factory in Vientiane; setting up of a number of motorcycle assembly plants; completion of the Nam Leuk and Nam Mang III hydropower plant and a number of other hydropower projects; expansion of the installed capacity of the Nam Ngum 1 from 150 MW to 155 MW; completion of a number of high-voltage transmission lines; and pilot installation of solar energy production systems. The total installed capacity of power plants by 2005 reached approximately 690 MW. The construction of some other major power plants/projects, as part of the five-year Plan has commenced, including the Nam Theun 2 Hydropower Project. Trade liberalisation, improvements in the enabling environment for business, and reduced logistics and transport costs contributed to increasing incentives for investment in industrial production.

Most of the industrial products have achieved higher growth rates compared to 2000, including coal, salt, beer, soft drinks, tobacco, animal feed, soap, leather shoes, pharmaceutical drugs, plastic products, furniture, ready-made clothing, bricks, cement, manual agricultural instruments, and agricultural machinery. In particular, the operation of the Sepon gold mine in Vilabouly District, Savannakhet Province, started in 2003 with a production of approximately six mt each in 2003 and 2004, with a projected increase to 6.5 mt in 2005. The mining industry has developed rapidly, as illustrated by the investments by 90 companies in mining at the end of 2005, of which 34 are foreign and 56 are domestic. The number of handicraft businesses in the country also increased rapidly in the last five years, especially in Vientiane City and in a number of major urban centres. By 2005, there were 26,200 industrial-handicraft units (rising from 23,574 units in 2001).

Currently, a number of industrial zones have been established in such places as Vientiane and Savannakhet. They include many standard to modern technology zones, attracting investment from many enterprises. The development of such industrial zones has helped to attract more foreign investment. Industrial development in certain areas and focal economic zones was firmly maintained. Areas with a high proportion of industries, such as Vientiane City and the provinces of Champasak, Khammouane, Bolikhamxay, Luang Namtha, Xayaboury, and Savannakhet, maintained high growth rates.

The participation of different economic sectors (such as domestic and foreign private investors and the State) in the manufacturing industries has facilitated its diversification in terms of manufacturing scale, level of technology, types and quality of products. The industries are thus able to meet the various demands of the market. The industrial sectors were responsible for creating the most jobs.

2.3.3 Services Sector

The services sector has taken positive steps forward to better meet the requirements of production, trading, and daily life. The availability and quality of products and services are higher compared to the beginning of the period. Over the five-year period (2001-2005), the growth in total retail sales and revenues from services averaged at 10 percent per year. The value added in the services sector grew at an average of 6.7 percent per year over the five years, which exceeded the GDP growth rate, although the growth rate was still less than the Plan target of 8-9 percent per year.

A number of services have developed quite effectively, such as trade, transport, telecommunications, tourism, hotels, and restaurants. More specifically, several services sectors essential for the development of new economic bases such as finance, banking, and insurance have experienced strong growth. An increasing and more diversified number of enterprises are entering the trade and services markets. In 2003, about 61,200 enterprises were registered. Trade infrastructure has been improved. By the end of 2003, there were 209 large markets, including 11 markets at international border cross-points and 28 markets at local border cross-points.

The service subsectors are currently being restructured and moved toward the market mechanism under state guidance. The legal framework has clearly defined the direction for market operations. The Business Law, the Investment Law, decrees relating to business operations within the country, and export and price regulations have been put in place with increasing efficiency. The central Government is currently continuing the process of decentralization in order to enhance local ownership of the regulation of commerce, mainly in such areas as investment licensing, business licensing, issuing certificates of origin, and export permits.

The tourism sector has also developed rapidly compared to the 1990s, despite the unfavourable international context during the first three years including the Iraq War and the outbreak of SARS. Since 2004, with more favourable domestic and international conditions, tourism has regained momentum and resumed strong development. Tourism infrastructure was quite efficiently improved, with the number of hotels and guesthouses increasing from 468 in 2000 to 887 in 2003 and about 1,200 in 2005. The number of hotel rooms increased from 7,333 in 2000 to 20,000 in 2005. A number of new tours, including tours among countries in the Mekong Basin, have been designed and introduced, and are attracting a substantial number of international tourists. The different types of tourism are growing in a diversified manner, offering more attractive tourism products. By mid-2005, the country had 364 tourism sites to attract domestic and foreign tourists.

In the five-year period (2001-2005), about four million foreign tourists visited the Lao PDR, averaging at about 800,000 tourists per year, with 900,000 in 2004 and about 1.05 million in 2005. Overall, the total number of foreign tourists to the Lao PDR over the five-year period (2001-2005) increased annually by nine percent. The sector revenues reached over US$100 million per year. The number of tourists from wealthy regions and countries, such as the United States, Canada, Belgium, Germany, Holland, Norway, the United Kingdom, France, Japan, Sweden, and Switzerland, is increasing. Specifically, the proportion of tourists from the European countries increased from 11.7 percent in 2000 to 14.8 percent in 2003 and about 16.5 percent in 2005.

The strong growth experienced by the tourism sector in recent years was supported by the Government's increasingly open tourism policy, which upholds tourism as one of the eight focal economic sectors to be developed in the Five-Year Plan. The Lao PDR has established tourism relationships with many countries around the world with a focus on ASEAN members and countries in the Mekong Sub-Region. By the end of 2005, entry visa requirements were lifted for tourists from several countries in the region. Thirteen land border crossing-points were upgraded into international border crossing-points to welcome tourists, and facilities were provided for the issuance of visas on arrival. Also, participation in different events was ensured to attract tourism from different markets and a number of events relating to domestic and international tourism were organized in the Lao PDR. The country hosted an ASEAN Tourism Forum in 2004 (ATF 2004) in Vientiane Capital, which marked a cornerstone in the opening of a new era in tourism in the Lao PDR. In 2006, Luang Prabang was awarded a gold medal for being voted as the most popular town in tourism in a survey answered by over 100 travel companies in the UK.

The transport and freight services have shown quite positive and uniform development, with initial improvements in the quality of services, in spite of the severe impacts of the Iraq War and the SARS outbreak. The freight volume increased at an annual average rate of about 11 percent and circulation by 15 percent. The passenger volume increased by about seven percent per year and circulation by five percent per year. In particular, the volume of transborder shipping increased strongly at an average of over 20 percent per year. The number of deaths due to road accidents was reduced significantly from 19 per 10,000 vehicles in 2001 to 10 in 2005.

During the last five years, the transportation sector emphasized the implementation of different projects, including the maintenance of existing roads and bridges and the transportation system as a whole. Simultaneously, the construction of regional roads, national roads, a railway system, airports, bridges, and a number of important local roads has continued. Significant achievements include the completion of the construction or paving of many roads to ensure smooth year-round transport. A number of important projects including new construction, improvement, and upgrading of over 1,130 km of roads and 39 bridges with a total length of 2,611 metres were completed. The number of transportation services by land and river has increased by about 10-12 percent per year. At the same time, many ports were built and upgraded, especially along the routes of the Mekong River. The airport system was also built and upgraded, including the improvement of the Wattay International Airport and the upgrading of the Luang Prabang and Pakse airports to international standards. About 14 kilometres of the railway along the Friendship Bridge to Khamsavat village was surveyed and designed. Also, the survey and feasibility study of the railway project from Thakhek to Kiumuya was carried out.

The telecommunications services have continuously developed and reached both urban and rural centres, including in mountainous and remote areas, with the quality of services significantly improved. The number of telephone users has increased, with the landline and mobile telephone subscribers reaching 87,500 and 327,000, respectively, by the end of 2004/05. The number of public telephone booths increased to 404. In general, telephone subscribers of all types reached 415,900, with an average coverage of

7.3 lines per 100 people, which exceeded the Plan target of 2.5 lines per 100 people by 2005. There are 2,570 internet shops all over the country. By 2005, 80 percent of the districts and 60 percent of the communities will be contactable by telephone. There will be around 130 post offices in 104 districts and about 23,247 public post boxes. Postal and telecommunications services are being provided to accelerate modernisation. Freight, mail, and money order (transfer) services in the country and internationally have increased at a moderate level.

The finance, banking, insurance, and other services have also continued to be established and expanded. The insurance market has been established with the participation of both domestic and foreign actors.

2.4 Foreign Trade

Foreign economic activities developed well. The Lao PDR has been more proactive in regional and global economic integration. The Lao Government needs to work with potential domestic and foreign investors to ensure that the country benefits from the liberalisation of trade in agriculture products under the ASEAN Free Trade Agreement and various bilateral agreements.

2.4.1 Exports

The aggregate value of exports over the five-year period (2001-2005) is expected to reach US$1.83 billion. Export growth rate averaged at about seven percent per year, exceeding that achieved in the previous five-year period (1996-2000) (average of 1.6 percent per year). However, the growth rate was lower than the Plan target of 8.6

percent per year. The average value of exports per capita was US$86.7 in 2005; it remains far lower than that in other countries in the region.

Until now, a group of key export products have been developed, including electricity, coffee, wood, handicrafts, garments, and minerals, in addition to a number of new emerging products with potential such as tea, rubber, vegetables, fruits, oil plants, fragrant rice, corn, and many types of beans. The share of agriculture, forestry, and fishery products in export revenues shows a decreasing trend. In contrast, the proportion of light industry and small industry products in exports increased significantly with garments ranking at the top.

Conducive foreign policy has allowed the Lao PDR to gradually integrate into the regional and international economies and has helped to diversify its markets. From the period when traditional markets consisted of Thailand, Viet Nam, and China to the end of the Plan, exports are now destined to 40 markets, which include the larger markets such as the European Union, USA, Japan, Australia, the United Kingdom, France, and Germany. Border trade has also developed strongly. More prominently, during 2001-2005, many FDI enterprises have invested in export-oriented manufacturing activities.

In 2005, export revenues reached approximately US$456 million (US$ 500 million was planned for 2005) of which agriculture and forestry exports represented 10.2 percent, heavy industry (electricity, electronics, machinery, etc.) and minerals covered 42.8 percent, with light industry and handicraft products accounting for the rest (47 percent). The exports accounted for 1.5 percent of GDP.

2.4.2 Imports

The total value of imports over the past five years amounted to US$2.86 billion with an average annual increase of 4.9 percent, exceeding that in 1996-2000. However, it remains lower than the Plan target of 8.6 percent per year. The value of imports per capita in 2005 was about US$122.30. The composition of imports has changed in accordance with the capacity and requirements of the economy. More importantly, the proportion of rice and food products in imports declined significantly from 32.6 percent in 2000 to 9.9 percent in 2002 and approximately 4 percent in 2003. By 2005, the value of imports is expected to reach approximately US$595 million, with equipment, machinery, and parts making up 39.2 percent; raw materials and fuel at 47 percent; and consumption goods at 13.8 percent. By 2005, imports accounted for 1.9 percent of GDP.

2.5 Foreign Direct Investment

From 2001 to 2005, the Lao PDR has received 585 FDI projects with a total committed capital of US$2.8 billion. However, only US$1.07 billion worth of funds were actually brought in (disbursed) during the period. The agriculture sector received 14 percent of the total number of projects accounting for seven percent of the total investment capital; the industry and construction sector received 48 percent of the projects and 79 percent of the investment capital; and the services sector received 38 percent of the projects and 14 percent of the investment capital. In particular, in fiscal year (FY) 2004/05, a total of US$1.3 billion of FDI projects were approved, with US$449 million brought into the country during the year. In the five-year period, FDI disbursements reached US$933 million of which US$326 million was received in 2005. Capital injected from abroad reached US$855 million, accounting for 91.6 percent of the total. Disbursements in the industry and construction sectors account for 69 percent, in the services sector at 27 percent, and in the agriculture, forestry, and fisheries sectors at 4 percent. The proportions of investment in the agriculture and services sectors show an increasing trend.

Overall, FDI has made a positive contribution to the manufacture of goods, economic growth, and the restructuring of the economy. It also helped to develop the private sector. These achievements were attributed to the incentives provided by the Government and other measures, such as the decentralization of foreign investment licensing. From 2005 onwards, provinces have been delegated by the authorities to license foreign investment projects valued up to US$2 million. This has led to significant increases in FDI compared to the beginning of the Plan period. Annual forums with investors and businesses were organized to discuss constraints and explore solutions. At the same time, the infrastructure has been improved rapidly providing better facilities to attract FDI. In October 2004, the National Assembly revised the Law on Foreign Investment including the incentives, thereby paving the way for more FDI in 2005 and thereafter.

2.6 Labour and Employment

During the past five years (2001-2005), a number of articles in the Labour Code have been amended and supplemented. A Government decree guiding the implementation of the revised Labour Code, the Civil Service Law, the Law on Minimum Wages, and the Law on the Establishment of the Social Welfare and Social Security Reserves was promulgated. A vocational training centre was set up in Vientiane. From 2001 to 2005, about 100,000 people have undergone vocational training, lagging behind the Plan target of 300,000.

A new policy on foreign workers in Laos has been drawn up, especially applicable to technical workers in industrial plantations such as rubber, coffee, and cashew, and in a number of industries such as electricity, coal, cement, and agro-processing. Thanks to the policy, thousands of foreign workers (from Viet Nam, China, and Thailand) poured into the country and facilitated technology transfer. At the same time, sister cities and provinces in Viet Nam and the Lao PDR have established business networks to exchange experiences.

A number of labour centres were set up providing opportunities for Lao labourers to go to Japan, Malaysia, and Singapore. A Government decree guiding the movement of Lao labourers overseas was promulgated. Two state-owned enterprises (SOEs) and some private enterprises were established for employment promotion. Additionally, an Agreement on Labour Cooperation was signed between the Lao PDR and Thailand.

One of the aims of the Government's policy is to encourage private enterprises to provide technical and vocational training. By the end of 2004/05, there are over 100 private training centres in operation in the country. In particular, they provide training for highly profitable and low investment professions, such as English language, computer applications, and accounting. The Government also promulgated a policy, which allows foreign workers to open a human resources training centre in the country.

2.7 Poverty Reduction

Poverty reduction is the core task in the socioeconomic development guidelines of the Party and the Government of the Lao PDR. Promulgated were the Prime Minister's Decree No. 10 and other resolutions to implement poverty reduction efforts, which have progressed significantly during the past five years. These initiatives have been implemented aggressively by CPI (Committee of Planning and Investment), public organizations, and the four priority sectors (agriculture and forestry, education, health and infrastructure) in the localities with the participation of poor people, especially in the 10 pilot districts selected from the 47 poorest districts. The latter (47 poorest districts) include 2,935 communities with a population of around 1.2 million people in 111,850 poor households, which account for 55.4 percent of the total poor households in the country.

In 2003/04, CPI issued regulations and mobilized village development funds (including from the budget) for poverty reduction. By 2005, there were 192 village development funds with 10,925 members. The Government injected an input of 18.3 billion kip into the funds. With a loan of US$20 million from the World Bank, the Poverty Reduction Fund has implemented 1,212 projects, valued at US$8 million in 1,913 villages in 20 districts in five provinces. There are also other poverty eradication projects, including the projects supported through foreign cooperation that made progress and are well organised.

So far, the land-forest allocation program has presented 1.09 million ha of agricultural land and 3.6 million ha of forested land to 419,259 households in 7,125 villages. Areas under slash-and-burn cultivation have been reduced from 118,900 ha in 2001 to 29,400 ha in 2005, fulfilling 75 percent of the Fifth Plan target. Of this, 72,870 ha have been put under industrial trees.

Shifting cultivation and opium production have reduced in a most noticeable way. Almost 19,000 ha of opium fields were destroyed and nearly 30,000 ha of slash-and-burn fields were converted into industrial tree plantation areas. By the end of 2004/05, 10 provinces—Oudomxay, Luang Namtha, Bokeo, Vientiane, Phongsaly, Huaphan, Xiengkhuang, Xayaboury, and Bolikhamxay—and one special zone were officially declared to be free from opium production.

The Government has designed and implemented economic development projects (in different sectors, including agriculture and forestry, and industry and construction) and invested in the construction of infrastructure, such as roads, schools, and electricity grids, as well as in the social sectors, such as health, education and training, culture, and communications with the purpose of reducing poverty. The labour and social welfare line authorities actively built and developed forms of model families in the poverty reduction movement through reorientation from shifting cultivation and opium production to the production of industrial crops, livestock, handicrafts, trade, and services to gradually uplift the quality of life of the affected populations.

In 2000/01, about 38 percent of the population was below the national poverty line (or classified as poor). According to the reports from the provinces, there were 304,100 poor households[1] in 2002 and the Plan target was to move some 150,050 households out of poverty. From 2001 to 2005, some 137,500 families graduated from poverty, achieving about 90 percent of the Plan target. Model associations of villages and groups were formed and tested for the development of commercial production including the establishment of development funds promoting commercial production. Similar models

[1] The definition of poor families is based on the standards specified in the Prime Minister's Instruction No. 10, which includes income and access criteria. However, the number of poor households in 2004/05 will be much larger if the national (income) poverty line from the Second or Third Lao Expenditure and Consumption Surveys (LECS II or III) is used.

were formed and tested for the elimination of shifting cultivation and the eradication of opium production. Local potentials have been tapped to generate incomes for the poor.

Savings groups were being organized and credit funds were established by mobilizing the participation of poor households to assist the households to develop their production and increase their incomes through low interest loans. These funds are closely managed and shared equitably as demonstrated by the Women's Union Group of Somsavi Village (Saithany District, Vientiane Capital).

3. CHALLENGES AND CONSTRAINTS

Although the achievements attained in the five-year period (2001-2005) are highly positive and praiseworthy, a number of challenges and constraints still remain, which are enumerated briefly in the following:

3.1 Economic Growth in Real Sectors

The growth of the economy remains unstable, and has not generated adequate investments nor realised its full potential. Although there has been progress, the quality of growth and the efficiency and competitiveness of the economy remain low and slow.

3.1.1 Agriculture Sector

In the agriculture sector, small-scale and subsistence production is still widespread. The production in this sector has not achieved the planned target and its full potential. The introduction of modern cultivation systems remains slow. Agriculture production is still concentrated on rice. Animal husbandry needs to be further developed. Crop production, animal husbandry, and the quality of agricultural products, albeit increasing, are still low and seasonal, dependent on the weather. The structural modification of agriculture production and the composition of the rural economy are still slow and do not yet guarantee stable components. Commercial production in several areas is not linked to processing industries and market demands. Overall food production is sufficient to meet the domestic demand, but about one-third of the districts do not yet have a sufficient production of rice to meet the consumption requirements for the whole year. The most important constraints to agriculture development are weak market institutions, formal and informal barriers to national and regional trade, high transport costs, and lack of supporting urban infrastructure and service.

The use of inputs in the agriculture sector remains inefficient, more particularly in the irrigation subsector. Although agricultural production has increased significantly, it has not met the economic requirements. Many goods could be produced locally and efficiently, but insufficient efforts for their development resulted in substantial imports of these goods. The sector-wide quality and efficiency needs to be improved further.

3.1.2 Industry and Construction Sector

The production costs in the industrial sector remain quite high. Very few enterprises use modern technologies and most of these are foreign-owned. Public investment in the industrial sector remains low due to the excessive focus on the agriculture sector (particularly irrigation), infrastructure (mainly roads and ports), and services. There is a lack of incentives for different economic actors to invest in industrial development. Coordination between line agencies and local authorities to encourage industrial development remains weak. The handicrafts sector is not sufficiently developing at the local level. Although advanced techniques are used, its development remains limited.

3.1.3 Services Sector

The services sector infrastructure is still very limited and is not adequate to meet the socioeconomic development requirements. As a result, the quality of many types of services is still low. Management of services shows several shortcomings, including control on investors, personnel management, and the management of family and private enterprises engaged in the provision of services. The coordination between Government officers and sectors at the local level in planning the development of infrastructure, tourism, and others is still very weak, resulting in low efficiency.

3.1.4 Infrastructure Use

The application/use of infrastructure in the activities of many sectors is still very low since production is not developed at the same pace as the development of physical infrastructure. Most prominent is the very limited capacity to make efficient use of irrigation schemes, ports, airports, etc. This results in waste and a reduction in the cost-effectiveness of investments.

3.2 Financial Sector

3.2.1 Savings and Investment

The ratios of savings and investment to GDP, although significantly improving, are still low compared to the potentials and the development requirements. The difference between domestic savings and public investment is significantly high and requires the use of foreign funds, mostly in the form of loans. The mobilization of savings for investment is still limited since the Government has not yet secured the sources of adequate revenues and the enterprises in different economic sectors have not yet sufficiently developed. Also, there are still no policies and detailed mechanisms to convert land and other resources into sources of capital.

The mobilized funds for investments are limited and are not concentrated on strongly encouraging structural adjustments for the development of the potentials of different areas, developing the skills of the labour force, eradicating hunger (scarcity of rice), and reducing poverty. Investments in infrastructure are scattered and the implementation of projects is often delayed. Debts incurred for financing the construction of infrastructure are substantial, and the debt service obligations create pressure on the budget and prices.

3.2.2 Financial Sector

The use of foreign currencies in transactions by enterprises and the general population is still widespread.

Interest rates on loans extended to economic entities remain substantially high although the rate of inflation has declined significantly, thereby adversely affecting economic growth.

The financial market is developing within a limited scope. Credit is limited and meets only 15 percent of the requirements. The loan amortization periods are short and there is pressure on the operations of enterprises and the capacity of the commercial banks to recover loans. The volume of repayments overdue in the banking system is substantial and is concentrated mainly in the domestic commercial banks, which suffer from poor financial capacity and quality of transactions. High nonperforming loans (NPL) are a drag on credit flow and high interest rates remain.

3.3 Economic Fundamentals

Until now, the economic base of the country remains to be relatively small. The total GDP in 2005 amounted to only US$2.8 billion, with an average GDP per capita of US$491. These indicators for the Lao PDR are among the lowest for the countries in the region, and it remains one of the poorest countries in the world. The economy's growth rate is yet to reach its full potential. With the low economic base, even if the rate of growth of the economy accelerates significantly, the absolute value added to the GDP would remain modest. The gap between the GDP per capita of the Lao PDR and that of other countries in the region continues to widen.

3.4. Structural Adjustment of the Economy

3.4.1 Structure of the Economy

The adjustments in the structure of the economy largely focus on the sectoral composition of GDP, concentrating on the rate of industrialization. They do not take into account adequately the goals in structural adjustment in line with the direction of industrialization and modernization, with strong technological and technical developments. Therefore, the development of domestic industries is characterised by obsolete technologies, high costs, and low efficiencies. This requires high protection/subsidies, thus reducing the competitiveness of the economic sectors in the long run in the process of international integration. Structural adjustments in the agriculture sector have only recently been initiated with the conversion of low-productivity (and low-value) rice cultivation lands into industrial plantations. The economic components of the agriculture sector are not strongly linked to the processing industries and markets. The economic structure in rural areas is mainly and solely reliant on agriculture, which accounts for 84 percent of the people's livelihood. The sale of a number of agricultural products is difficult due to high production costs and low quality. Many products are not competitive.

3.4.2 Geographic (Spatial) Structure

The geographic (spatial) structure of the economy shows considerable disparity, with large variations in the growth rates and a relatively low level of development in many northern and southern provinces. The economies in many areas remain unbalanced and the territorial potentials have yet to be strengthened. At the same time, the economic transition still remains slow, and a large share of the land is in agro-forestry. The development gaps between urban and suburban, provinces/territories, economic sectors, and the ethnic groups are large. Therefore, it is difficult to identify the intrinsic (but concealed) potentials in each province/territory.

3.4.3 Labour Force

The skill level of the labour force is developing slowly compared to the improvements in the economic components in each sector and area. The capacity development of the labour force is characterized by self-improvement, with only occasional opportunities for training, resulting in casual labour. Without proper institutional arrangements and training programmes, it would be difficult to achieve the objective of appropriately redistributing the labour force and population to meet the requirements of industrialization and modernization.

3.5 External Economic Relations

3.5.1 Foreign Trade

Exports and imports still face severe constraints. Exports per capita are still extremely low due to constraints in large-scale commercial production and in processing higher quality products. The export of unprocessed and low value added agricultural products accounts for a major proportion (about 50%) of the export revenues. Therefore, the value of exports is low and may be reduced easily due to fluctuations in price. Moreover, more than half the revenues from Lao exports are generated from products for which markets are unstable (e.g., garments), or the volume has reduced (e.g., wood), or which suffer from price declines (agricultural products). Interestingly, the rate of growth of exports is not yet stable and is lower than the GDP growth rate, while the exports of many countries in the world are increasing twice as fast or faster than the growth in their GDP.

The foreign trade management policy framework and measures need to be further developed in detail. The existing framework and measures do not ensure overall coverage and lack long-term vision, affecting their efficiency. In many cases, they demonstrate a lack of ownership, especially in the management of imports. Coordination between central and local authorities on exports and imports is still weak and inefficient. There is still a widespread shortage of management officers, technical staff, and workers with high technical skills.

Even though substantial imports have significantly contributed to the successful growth of domestic production and exports, they are increasing faster than the rate outlined in the Fifth Plan. The management of imports still faces severe difficulties. There is a general lack of market information and most of the imports are concentrated on smaller markets, and many technologies have been imported but obsolescence is still pervasive.

3.5.2 Foreign Investment

Foreign investment increases at a slow pace. Investments in the agriculture, forestry, and fisheries sectors and areas with difficult access are very limited. At the same time, the capacity to attract investments in the industrial sector remains low. The licensing process is time consuming and cumbersome. Foreign investors face many difficulties due to the insufficiently open investment environment, inadequate facilities, and the lack of consistency and predictability. The costs of inputs such as fuel, electricity, telecommunications, and shipping are much higher than in many other countries in the region, restricting the competitiveness of Lao products and services and the attractiveness of the Lao PDR to foreign investors. Also, there are very few investors with the capacity to raise large volumes of funds from the regional and international economic groups.

One of the main causes restricting the growth of foreign investment in the Lao PDR is the insufficiency of skilled labour. Currently, skilled labour represents only two percent of the total labour force and is not able to meet the requirements of foreign enterprises that need highly skilled labour.

3.6 Social Development

3.6.1 Education and Training

In the education and training sector, repetition and dropout rates are high and increasing. In 2005, the dropout rate was 8.9 percent at the primary level, 7.2 percent at the lower secondary level, and 3.2 percent at the upper secondary level. The repetition rates at primary schools, mostly in year 1, stood at 34.1 percent. Due to the low quality of graduates, few are accepted in the labour market, while the remainder are forced to work in sectors other than their areas of training.

The issue of insufficient teachers and substandard teachers has dragged on for many years, but efficient solutions have still not been applied. By 2005, about 19 percent of the teachers had not been properly trained. The curriculum is obsolete, while enrolment at the lower and upper secondary levels remains generally high. Current treatment of teachers and the management of the teaching corps are characterized by many inconsistent elements and fail to encourage teachers to undertake proper training as well as capacity enhancement activities. Teachers are paid very low salaries irregularly. Classrooms are insufficient to accommodate the rising number of students. This leads to a phenomenon where classes need to be rescheduled in lower and upper secondary schools. The ratio of students per class is high at around 70-80.

The literacy rate remains very low. The survey data show that in 2005, only about 68.2 percent of the people aged 15 years and over are literate, which include the 15-39 years age group with a literacy rate of 78.6 percent. According to another review, only about 45.2 percent of the population are literate with a breakdown of 53.7 percent for men and 36.3 percent for women. This review also indicated that only 37.7 percent of the literate population have a normal level of application of their literacy skills and 30.8 percent are able to make good use of their literacy skills in their activities.

The training of personnel, workers, and skilled artisans does not meet the requirements of the labour market and the society. The development of education in isolated, ethnic, and highland areas is very slow. Illiteracy eradication efforts are not yet based on strategic plans and detailed procedures, and a substantial portion of the population is still illiterate.

The implementation of scholarship awards is slow. In 2005, only about 7.5 percent of persons with merit have received assistance, representing only 30 percent of the Plan target. (The Plan provides for the provision of assistance to 25 percent of students through different means.)

The education sector suffers from a severe lack of equipment and tools, particularly textbooks, learning materials, and school facilities. Teaching fails to meet the requirements. The ratio of schools meeting the standards set by the Government is still very low. The budget allocations made to education are very limited and not constant, with a peak of only 10 percent of the total budget expenditures. Within such allocations, up to 80 percent are provided from external grants, and the mobilization of these funds is subject to increasingly difficult conditions. The National Assembly agreed to allocate 12 percent of the budget to the education and training sector, but none of the provinces have yet received such an allocation.

3.6.2 Employment

The need for new employment opportunities is huge, but employment generation is slow and there is a high level of unemployment. The allocation of the labour force is shifting slowly, and has not brought about significant changes in socioeconomic development. Subsistence production results in the underemployment of labour and makes the management of social issues more difficult. The lack of external communication results in an inward-looking (insular) economy. The labour cooperation mechanism is not yet open to facilitate labour movement among districts and provinces, as well as other countries in the region.

3.6.3 Poverty Reduction

In poverty reduction efforts, due to insufficiently firm coordination between the relevant agencies and unified guidance from the Government, each agency is left to carry out their sector's activities independently. The overall supervision, assessment, control, and monitoring of poverty reduction activities have not been entrusted to any agency.

Clear and specific credit policies need to be outlined to allow public funds to reach producers when required, and proper mechanisms need to be established to mobilize domestic and foreign resources to establish funds that would extend credit to the poor for the development of production activities and the reduction of poverty.

Civil servants including the technical staff of local administration authorities are insufficient in number and have inadequate capacities, and a substantial number have minimal qualifications. This is a major constraint to the dissemination of policies and programmes and the implementation of policy guidelines adopted by the Party and the Government, thereby affecting the efficiency of poverty reduction efforts.

3.6.4 Social Security

The establishment of an efficient social security system for all Lao people to alleviate poverty is a long-term objective. Public servants are covered by a comprehensive range of provisions including pensions and health care financed partly through a six percent deduction from salaries and partly from the state budget. In 1999, the Government adopted a Decree on Social Security System for Enterprise Employees, establishing the foundation of a National Social Security Scheme. It called for the creation of a Social Security Organisation (SSO) that began operating in June 2001. The SSO administers the Social Security Scheme for enterprise workers in the private and the SOE sectors. The scheme provides protection coverage with respect to a range of contingencies/risks including the following:

- Access to health care from an approved health care provider for insured workers and their families;
- Long-term pensions in case of invalidity or old age and to surviving dependants;
- Short-term benefits in the event of incapacity to work by virtue of sickness or maternity; and
- Benefits in case of incapacity to work by virtue of an employment-related injury or sickness.

However, a very low proportion of workers are covered under the formal social security systems. Only 4.7 percent of the total labour force, with about 28 percent in Vientiane City, has social security coverage. In 2005, care and aid were given to only 7.5 percent of the total beneficiaries, accounting for 30 percent of the set target.

4. DEVELOPMENT PERSPECTIVES AND STRATEGIES

4.1 Development Context

On the positive side, there has been political and social stability over the past five years, and this situation is to be strongly maintained. The production capacities and abilities of many industries have increased substantially, and the economic structure has changed significantly. The enterprises and the national economy have adapted better to the international market, and the competitiveness of Lao products has improved steadily. The economic structure has changed progressively, and the implementation of the Party's instruction has been implemented methodically in priority projects. The market economy structure has been adjusted and progressively improved. The geographic location and natural resources of the Lao PDR attract tourism and investment. The country has been recognized as the transit center of the region.

Over the past five years (2001-2005), the production capacity and ability of many industries increased substantially, and the economic structure changed significantly. The quality of growth in many industries and regions has improved somewhat, with the enterprises and the national economy adapting better to the international markets. New and more radical policies introduced in the recent five years had positive impacts, attracting more investment from the society, especially utilizing internal resources for targeted investments, and bringing about structural changes in the economy.

The country has been recognized in the region and globally as having a dynamic economy within a stable political situation, and a safe destination for investment and tourism. Sociopolitical stability is an important foundation and an essential precondition for socioeconomic development, which is an advantage that the Lao PDR enjoys now.

The full membership of the Lao PDR in the regional and global political, economic, and monetary organizations including the World Trade Organization (WTO) will boost the dynamism of the economy and accelerate the country's development.

4.2 Government's Development Strategy Framework

4.2.1 Overall Development Strategy

The overall development strategy for the Lao PDR is based on the Lao Government's national development strategy framework mainly: (i) the Long-Term Strategy of Socio-Economic Development to the Year 2020; (ii) the Strategy on Industrialization and Modernization; (iii) the National Growth and Poverty Eradication Strategy (NGPES); (iv) The Sixth Five-Year National Socio-Economic Development Plan (2006-2010); (v) the Regional Development Strategy; (vi) various sector, thematic area, and subsector strategies and plans; and (vii) the analysis of the international and domestic contexts for the development of the Lao PDR.

The 7th Party Congress has set out the Ten-Year Socio-Economic Development Strategy (2001–2010) for the country, which includes improving and building the economic infrastructure to ensure fast and sustainable economic growth, with emphasis on agricultural production, eliminating forest fires and deforestation, reducing the number of poor households, and promoting industrialization and modernization. The country's human resources are to be developed step-by-step both in quality and quantity to cater to the emerging needs and make the country a regional centre for exchange of goods and services. The strategy encourages a socialist-oriented industrialization and modernization with infrastructure development to prepare the nation for graduation from the Least Developed Country (LDC) status by 2020 and to achieve improved well-being for all the Lao peoples. The objectives set out in the Strategy support the achievement of the Millennium Development Goals (MDGs) and the implementation of the Brussels Programme of Action for Least Developed Countries (2001-2010).

The Sixth Five-Year National Socio-Economic Development Plan (or Sixth Plan) covering the five-year period 2006-2010 plays a crucial role in implementing the socioeconomic development policy guidelines set out by the 7th Party Congress. It is the vehicle for facilitating the implementation of the second half of the Socio-Economic Development Strategy (2001–2010) approved by the Congress. The Sixth Plan institutionalizes and concretizes directives and tasks that will be carried out further during the five-year period 2006-2010, to ensure that the overall targets outlined in the Ten-Year Strategy (2001-2010) are achieved.

4.2.2 Development Directions

The directions set in the Sixth Plan (2006-2010) are to achieve the highest outcomes and make general changes along the following lines:

(i) Turn from underdevelopment to fast and stable development, producing high value-added goods both in quantity and quality step-by-step in order to meet domestic market demand and increase exports;

(ii) Increase competitiveness and utilize comparative advantages to implement effectively international economic commitments in the frameworks of ASEAN and other bilateral and multilateral commitments, including the WTO;

(iii)Strengthen links between economic development and social development, and protect natural resources and the environment. Social problems should be solved first, with attention paid to such issues as the reduction of poverty, unemployment, and social evils, and keep the social and political situation stable: and

(iv) Accelerate the building of a comprehensive socioeconomic infrastructure and finalize the establishment of a market-oriented economy with socialist orientation to form the basis for industrialization and modernization.

Thus, the Sixth Plan (2006-2010) is seen to be a breakthrough plan for creating a fast but firm and qualitatively enhanced development, with increased capacity for economic competitiveness, lifting the society to new heights both in material and moral wellbeing, significantly improving the quality of life of all the people, and boosting the nation's status in the international arena.

4.2.3 Overall Goals of the Development Strategy

The 7th Party Congress identified the general goals of the Socio-Economic Development Strategy for the 10-year period 2001-2010 as follows: "*Improve and establish the basis for the economy to progress strongly in firm steps, especially to strongly develop the agriculture sector; entirely eliminate the slash-and-burn cultivation practices; complete the tasks in solving the problem of poverty of people; create the foundation for industry; prepare the quality and quantity of human resources to be ready for industrial development and gradually turn to industrialization; and develop our country to become the central point of transit of the region in the future.*" The Party Congress identified the following key expectations: GDP in 10 years (2001-2010) to increase to an average of 7.5-8 percent per annum; GDP per capita in 2010 to be US$700-750; and the population growth rate in 2010 to be reduced to about 2 percent per year.

The main goals of the Sixth Plan (2006-2010) are to maintain all targets and views that have been set in the 10-Year Strategy (2001-2010). Therefore, the goals for the Sixth Plan are as follows:

"*Accelerate economic growth and improve the people's quality of life, restructuring the economy and employment in building a market economy, based on the country's rich resources and international integration. Further build the market economy with a socialist orientation. Continue to enlarge and develop effective external economic relations. Create breakthrough changes in education and training in terms of quality and quantity, utilising the advances in science and technology, protecting the environment, and taking human, scientific, and technological players as vehicles for development. Develop culture and society in synchrony with economic growth. Continue poverty reduction, creating jobs, and eliminating social evils. Continue strengthening the socioeconomic infrastructure as fundamentals for development in the Sixth five-year Plan and for the next (Seventh) five-year plan. Maintain political stability and social security, protecting sovereignty, territorial integrity, and national security.*"

Based on the goals set out above, the following tasks and guidelines are to be followed:

(i) Economic growth should be increased to an average of 7.5–8 percent per annum, establishing the fundamental economic players to support the next (Seventh) five-year Plan. Accelerate the progress of economic systems and enhance the potentials of products by region. To do so, the quantity and quality of goods and services and the level of competitive ability of all business enterprises and economic sectors must be improved, paying attention to the development of information technology and establishing the foundations for human resource development;

(ii) Ensure the balance in economic development in parallel with social development and protection of the environment, solving urgent social problems, and actively solving other ill behaviours in the society. Create job opportunities, reduce unemployment, uplift the people's level of material and mental wellbeing and living conditions, improve salary scales, reduce poverty, and take care of people who are national heroes and who have sacrificed themselves for the nation;

(iii)Encourage economic development in the various sectors by paying attention to the state economy as the leading sector; concurrently establish and develop other forms of the economy: collectives and private and foreign businesses; establish and implement the instructions and regulations related to the market economic arrangements with socialist orientation as a strong step. Pay attention to the creation of facilitating environments for investment and business activities in a consistent manner, and ensure transparency and a high level of economic competitiveness in the region;

(iv)Promote and develop small and medium enterprises (SMEs) to expand rapidly, and create the conditions to strengthen the financial status of state-owned business enterprises step-by-step, including the improvement of their debt situation;

(v) Ensure the maintenance of existing infrastructure; establish additional infrastructure specifically to support the socioeconomic development activities aiming to promote trade, investment, and tourism; increase the investment in the infrastructure for socioeconomic development; explore national resources including human resources to be used as potentials for development in an effective manner; establish and prioritize investment projects to establish effective economic structures and to be in a good position and ready for competition;

(vi)Continue to broaden economic opportunities and upgrade the level of external economic relations; create facilitating conditions to increase exports; attract investment in terms of funding and technology as inputs from external sources to support the production of goods and exports while taking ownership in economic integration at the international level: and actively and strictly implement bilateral and multilateral agreements at the central and local levels;

(vii) Continue to improve and strengthen the financial and monetary sectors by increasing the capacity of the national financial administration bodies; solve the problem of long-standing debts by utilizing many financial sources including financial balancing at local levels. Implement national policies on economization strictly; maintain macroeconomic balance; establish and develop financial markets to meet the needs of socioeconomic development activities;

(viii)Continue with progress on new changes to create comprehensive development approaches in the areas of education and capacity building; implement compulsory primary education programs; apply science and technology; upgrade the level of quality of human resources to catch up with the new changes in the economic structures; apply advanced and modern technologies in areas with favourable conditions with primary focus on economic areas at the center and in the provinces, municipalities, and cities;

(ix) Enhance the public administration activities with strong steps and improve and upgrade the effectives of state organizations. The relations between the state bodies and local people and business enterprises must be organized with transparent approaches allowing audits to be conducted; solve the problems of bureaucratic phenomena and corruption; and uplift the capacity of government officials in performing their duties;

(x) Strengthen the areas of national defence, public security, social and political aspects, and broaden foreign relations; maintain the society with stability; and create a favourable environment to support the development and protection of the nation.

The goals coincide with the MDGs and those in the Brussels Programme of Action for Least Developed Countries (2001-2010).

4.2.4 National Priority Development Programs:

To implement the overall development strategy successfully, the Lao Government has determined and approved 11 National Priority Development Programs for 2006-2010, namely:

1. Stability and Security Development Program
2. Comprehensive Agriculture Development Program
3. Forestry and Wood Processing Industry Management Program
4. Basic National Industry and Industrialization in Potential Sectors Program
5. Tourism and Service Promotion Program
6. Poverty Reduction and Stop Shifting Cultivation Program
7. Economic Integration and Investment Promotion Program
8. Communication and Transportation Development Program
9. Strengthening Macroeconomic Management Program
10. Human Resource and Cultural Development Program
11. Strengthening Effective Governance Management Program

5. POLICY RECOMMENDATION

Based on the challenges and problems discussed earlier as well as on the Lao Government's development strategy framework, policy recommendations for deepening integration, narrowing development gaps, and promoting sustainable growth in the Lao PDR are made as follows:

5.1 Infrastructure Development by Focusing on Land-linked Country and Economic Corridors

(i) Improve and developing transportation infrastructure with neighboring countries

(ii) Develop the transport corridors to become economic corridors

(iii) Develop missing links to provide a complete package of infrastructure along main economic corridors

(iv) Link all provincial capitals (and other key centres) to power, transport, and telecom networks via the main economic corridors

(v) Develop urban infrastructure in rural villages and towns.

5.2 Strengthening Private Sector Development (SME, Market Development)

a) Promoting private sector development

(i) Clarify and strengthen the supportive role of Government

(ii) Strengthen the Lao National Chamber of Commerce and Industry and Business Association

(iii) Promote and facilitate substantive dialogue with the business community

(iv) Promote and facilitate public-private development partnerships

(v) Simplify and clarify the policy and regulatory framework for private sector enterprise and investment

(vi) Strengthen trade access to neighbour country markets

(vii) Integrate with production networks, investment clusters, and trade hubs by establishing national and cross-border production chains and by urban planning and town development

(viii)Mobilize financial resources and facilitate access to credit

- Establish a sound banking system and extend the services
- Perform selective use of directed credit
- Mobilize and coordinate ODA support

(ix) Strengthen competitiveness through regular training on related activities

b) SME development strategy

(i) Create an enabling regulatory and administrative environment for SMEs;

(ii) Enhance competitiveness of SMEs;

(iii) Expand domestic and international markets for SMEs;

(iv) Encourage investments and improve access to financing by SMEs;

(v) Improve access to appropriate work premises;

(vi) Create favourable conditions for and facilitate establishment of business organisations;

(vii) Encourage entrepreneurial attitudes and characteristics within the society;

(viii)Finance SME development measures (programmes and projects).

c) Market development

Development of Financial Markets

(i) Establish strong regulations to control monetary-financial markets to facilitate foreign exchange operations and make the transfer (trading) of money in the market simple and transparent, while monitoring the movement of the volume of currencies in the market to ensure that it is consistent with sound monetary management.

(ii) Strongly study the development of the bond market, setting forth the interest rate to be consistent with the changing situation and the trading within the bond market. Terminate the sale of government bonds to commercial banks to solve the problems of triangle debts (of SOEs).

(iii) Consider developing the state-owned banks to enable the Government to supervise and monitor the performances of the monetary-financial system to be more transparent in solving doubtful debts through auditing of the accounts and the categorization of debts in accordance with international standards.

(iv) Promote microfinance , which can provide financial input for small enterprises in rural areas.

Labour Market Development

(i) The Labour Law should be improved in order to ensure the balance of benefits between employees and employers, promoting and facilitating the workforce to have jobs in both domestic and international markets. Promote all economic players (sectors) to actively contribute to the creation of jobs in both quantity and quality.

(ii) Improve the regulations on employment agencies (job seeking business) and dispatch of labour to work abroad in accordance with the direction of creating the conditions to enable multiple players to increasingly provide such services (more and more), while simultaneously improving the ability of the state to monitor the situation.

(iii) Establish an effective social insurance system, particularly the unemployment insurance, creating equality on providing social insurance for the employees of all economic sectors (e.g., public, private, and voluntary).

(iv) Improve the management system of labour markets within central and local regions.

(v) Promote the involvement of mass organizations and nongovernmental organizations (NGOs) in developing the labour market and assign them some responsibilities, such as training, skills upgrading, performance on the job, job creation planning, and supporting plans for start-up of enterprises.

(vi) Enhance the role of the trade union as the representative organization of the employees in order to facilitate the involvement of the labour force in plan formulation, setting forth policies on the labour (workforce) market, and monitoring the compliance with (observance of) the Labour Law.

Real Estate Market Development

(i) Consider developing the real estate market, with the rights of land usage and ownership of dwellings. Create mechanisms for facilitating transfer of rights of land usage and ownership of real estate. Provide opportunities for the citizens and enterprises that belong to other economic sectors to be able to own land, and have long-term leases for use in farming, for operating businesses, and to serve their daily lives.

(ii) Facilitate land usage to establish and develop medium and large-scale farms in the areas where there are good conditions.

(iii) Continue to disseminate the regulations on land use by Lao people living abroad and foreigners who invest in Laos.

(iv) Urgently formulate laws, especially the law on the real estate market, and the regulation on the registration of properties, along with the dissemination of legal documents.

5.3 Tourism development

(i) Develop and promote cultural, eco-based, and historical tourism in the country as a sustainable tourist-friendly destination

(ii) Facilitate the development of a more competitive tourism industry

(iii) Link the national and local tourism industry with neighboring countries

(iv) Integrate tourism considerations in town and community planning

5.4 Natural Resource-based Industry

a) <u>Must be an environment-friendly and environment-oriented industry</u>

(i) Implement ecological zoning, establish a strong environment-friendly legal framework, and develop an appropriate implementation mechanism.

(ii) Cooperate with neighbouring countries to stop illegal logging, especially in remote border areas (including the NBCAs bordering on China, Thailand, and

Viet Nam) that are hard to monitor. Greater cooperation among neighbouring countries is also needed to stop the illegal trade of endangered flora and fauna.

b) Must be an economically efficient and economic-oriented industry.

(i) Set appropriate resource prices: In addition to timber royalties, prices for hydropower concessions, water resources, and other natural resources in Lao PDR are normally set far below their marginal opportunity cost (MOC), leading to inefficient and wasteful resource use. Forest royalties are far below the MOC. In addition, pricing does not incorporate environmental externalities; pricing should not encourage overexploitation, as is now the case.

5.5 Develop the Processing Industry in the Country

(i) Develop agro-forest processing industry for export and domestic consumption.

(ii) Developme mining based construction material industry (brick, cement industry)

5.6 Human Resource Development

(i) Implement the policy of universal compulsory education at the primary level and continue to increase participation at the lower secondary level, ensuring that all people have the opportunity to apply their education to serve the socioeconomic development programme;

(ii) Strive to completely abolish illiteracy among the population;

(iii)Expand vocational, technical, and higher education to meet the needs of the new labour market and to improve the economic rates of return;

(iv) Train skilled workers, technicians, professionals, and intellectuals to have the capability to apply modern science and technology to serve the needs of socioeconomic development;

(v) Raise national education standards gradually to be closer to international standards;

(vi) Take education as the core of human resource development and invest appropriately in education; and

(vii) Make education a right and duty of all the people in society.

Chapter 12

CHALLENGES, PROSPECTS AND STRATEGIES FOR CLMV DEVELOPMENT: THE CASE OF MYANMAR

Kan Zaw

ABSTRACT

Since ASEAN economic integration is more than the liberalization of trade and investment and also linked with each other through many other means, the subregional growth areas of CLMV have been focused from Myanmar's perspective. This paper gives an overview on and insight into Myanmar economy. Statistical portrayals were updated. Trade indices and prospects were obtained from economic cooperation among ASEAN countries. In Myanmar, the nation-building tasks carried out in the past two decades are regarded as guidelines in carrying out peace and stability, as well as the balanced growth in its states and divisions. This paper highlights the National Development Planning, which focuses on the Development of Border Area: Plan for 24 Special Development Zones and Integrated Rural Development Plan. These remarkable national plans are expected to accelerate economic growth, achieve equitable and balanced development, and reduce the socioeconomic development gap between rural and urban areas all over the country. Also, regional infrastructure developments are included in the Growth Corridor Concept. For such efforts and its location advantage for future prospects, Myanmar deserves a closer look.

1. RATIONALE

The success of ASEAN economy reflects every facet of growth of Myanmar economy. Moreover, the lessons given by the 50 years of development have brought about new prospects for global and local economic development. Analyzing the contour of Myanmar economy and its present status will reveal that the nation has committed to strengthening its economy to move towards a new, modern, and developed nation. The developmental activities in all sectors and for all of Myanmar people are also within the nation's development terrain.

For more than a decade now, Myanmar has been taking several steps and adopting a number of strategic frameworks as comprehensive initiatives towards economic development. After going through a socialist period from 1962 to 1988, various reforms and measures were introduced during the early 1990s. These reforms broadly covered the areas of foreign trade, foreign investment, tourism, fiscal and financial sectors, legal system, the establishment of special development zones, and the development of frontier area administration. Since then, development has been extended to other areas. Taking its cue from the World Development Report, which prescribes that "a renewed commitment to comprehensive reform is needed to position the economy for recovery and growth and to lay foundation for reducing poverty," Myanmar undertook some initiatives to fix the economy and catch up with its neighbors.

It is necessary thus to expand the concern of economic integration as the vision of development strategy towards the age of economic integration, which is a challenging issue for all CLMV countries. Achieving sustainable development, developing the financial sector, and establishing the development fundamentals are essential measures to be undertaken for a comprehensive development of Myanmar. At this transition stage, Myanmar has declared that its development strategies are regionally feasible.

2. OVERVIEW ON MYANMAR ECONOMY

Adopting the market-oriented policy since 1988 was a significant change in terms of overall policy framework in Myanmar. The utmost goal of becoming a peaceful, modern, and developed country calls for the shared commitment by its citizens under the concept of "unity in diversity."

Three national initiatives or causes—nondisintegration of the union, nondisintegration of national solidarity, and perpetuation of sovereignty—are regarded as a national responsibility. Based on these three initiatives, the country has laid down twelve objectives (four political objectives, four economic objectives, and four social objectives). The thrusts for national development and the economic objectives laid down for the mission statements are as follows:

- Development of agriculture as the base as well as the all-around development of other sectors of the economy;
- Proper evolution into a market-oriented economic system;
- Development of the economy to invite participation in terms of technical know-how and investments from sources inside and outside the country; and,
- The initiative to shape the national economy must be kept in the hands of the state and the people.

To achieve the aforementioned economic objectives, the State Law and Order Restoration Council (SLORC)[1] initiated the economic reform measures in various sectors, under the following objectives:

- To adopt a market-oriented system for the allocation of resources and the distribution of goods and services;
- To encourage private investments and entrepreneurial activities in the domestic arena; and,
- To open the country to foreign direct investment and promote exports.

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[1] SLORC was renamed as State Peace and Development Council (SPDC) since 15 November 1997.

The nation-building tasks carried out in the past two decades are regarded as guidelines in carrying out peace and stability and the balanced growth of its states and divisions. The growth of economy is also considered as the basic pillar of development, too.

The rate at which the economy grows is regarded as one of the key indicators of economic performance. Annual growth rate of GDP, comparing the targets for the Second Five-Year Short Term Plan (1996/1997 – 2000/2001) and the Third Five-Year Short Term Plan (2001/2002 – 2005/2006) and the per capita GDP, are shown in Figure 1. The actual growth rate of GDP surpassed the target rate. Annual average growth rate of GDP was 12.8 percent during the period 2001-2002 to 2005-2006.

It is apparent that the growth of output in the national economy is taking the upward trend. Growth rate of GDP in 1999 to 2000 was 10.6 percent, the highest growth rate in the decade. Growth rate of real GDP surpassed the target rate in the early 2000s and the per capita GDP also soared. The GDP increased significantly from 2552.7 billion kyat in 2000-2001 to 4661.3 billion kyat (at constant price) in 2005-2006. The per capita

Figure 1: Rate of Growth of GDP (Actual and Planned) and Per Capita GDP

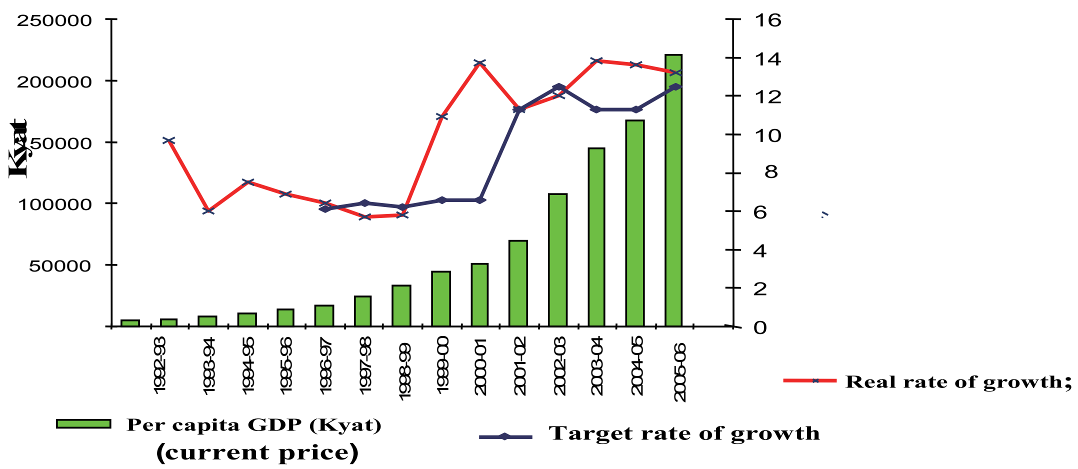


Table 1: Growth of GDP and Per Capita GDP

Year	Total GDP (in billion kyat)	Rate of growth of GDP (%)	Per capita GDP (in kyat)
1990-1991	151.94	2.8	
1995-1996	604.73	6.9	13,515
2000-2001	2,552.73	13.7	50,927
2001-2002	3,548.47	11.3	69,390
2002-2003	5,625.25	12.0	107,823
2003-2004	7,716.61	13.8	144,984
2004-2005	9, 078.93	13.6	167,202
2005-2006	12,254.55	13.6	221,217

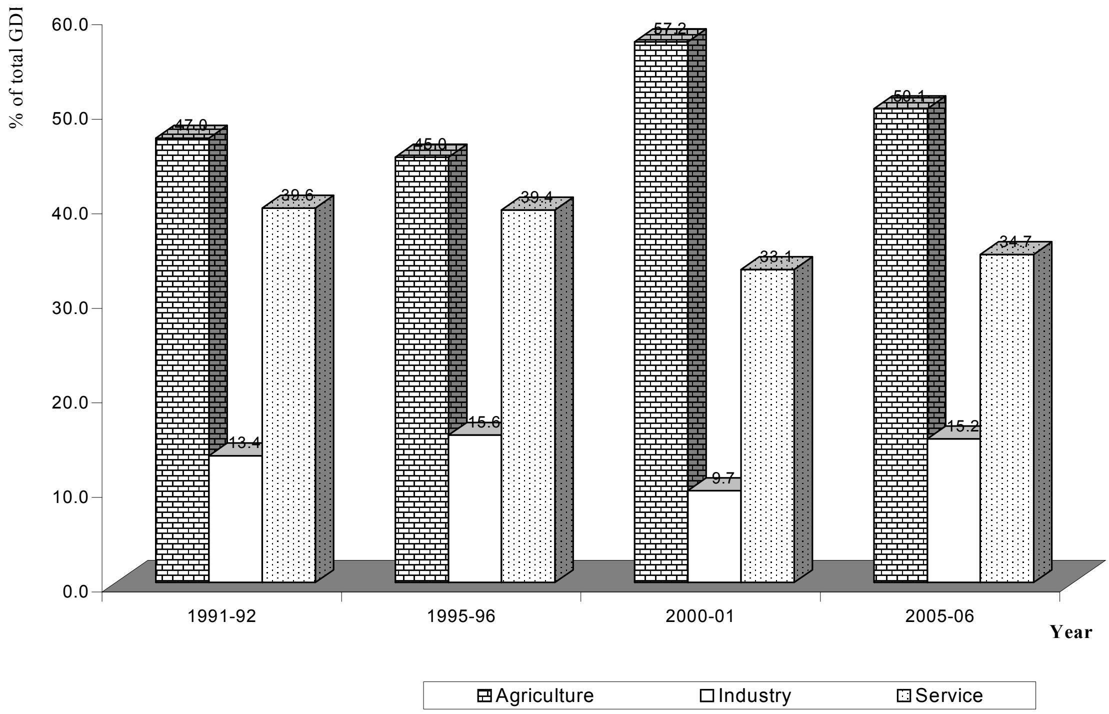
Source: Central Statistical Organization: Statistical Yearbook, 2005

GDP increased about 4.3 times, from 50,927 kyat in 2000-2001 up to 221,217 kyat in 2005-2006[2] (see Table 1).

To liberalize the economy, the government initiated a series of reform measures in various sectors (Appendix 1). As a result, the growth rate of GDP was over 7 percent per annum between 1992-1993 and1995-1996. Other factors contributing to this significant growth were the surge in the agricultural production mainly due to the introduction of summer paddies, growth in exports, growth in the tourist industry, and construction boom. The positive response of the private sector to liberalization policies clearly attest to the prowess and dynamism of Myanmar's private sector in promoting development. Figure 2 shows that, although agricultural sector still plays an important role in economy, service sector is considerably advancing in line with the market-oriented system. The industrial sector also slightly improved in 2005-2006. As a whole, sector-wise performance is flourishing.

[2] Statistical Yearbook ,2005 (Yangon: Central Statistical Organization, 2007)

Figure 2: Sectoral Shares in GDP



2.1 Development of Agriculture Sector

Agriculture contributed 47 percent to GDP in 1991-1992. Its contribution to GDP went up to 51.9 percent in 2005-2006. It accounted for 18 percent of total export earnings and employed 63 percent of total labor force in the same period. Seventy-five percent of the total population residing in rural areas is principally engaged in agriculture, livestock, and fishery sector.[3] To develop the agriculture sector, the government has taken measures to ensure sufficient water supply and fulfill the other requirements of this sector. Moreover, the government is taking steps to expand the yield of major crops: rice, beans, edible oil crops, jute, palm, rubber, sugar cane, cotton, and caster. For this purpose, priorities are being given to reclamation of vacant and virgin lands, cultivation of mixed and double crops, and boosting the per-acre yield. As a result, arable land

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[3] MNPED, Myanmar Economic Development , 2006 , MNPED

reached a total of 19.9 million acres in 1988-1989, and increased to 27.3 million acres in 2003-2004 and 28.3 million acres in 2004-2005.

As the liberalization of agricultural sector keeps in line with a market-oriented economy, agricultural marketing precedes two steps: domestic marketing reform in 1987 and export liberalization in 1988. The first step comprised the abolishment of compulsory delivery system and admission of private traders into agricultural trading. The second step covered the authorization of private traders to export freely as long as they were registered exporters.

As a consequence, both agriculture production and sown acreage increased dramatically. Paddy production increased from 13,164 thousand metric tons in 1988-1989 to 30,537 metric tons in 2006-2007. Production of beans and pulses increased from 371,000 metric tons in 1988-1989 to 4,265 thousand metric tons in 2007/06. In terms of sown acreage, paddy production increased from 11,807 thousand acres in 1988-1989 to 19,818 thousand acres in 2006-2007. Sown acreage of pulses and beans went up from 1,803 thousand acres in 1988-1989 to 9,890 thousand acres in 2006-2007.

Employment opportunities of landless laborers increased, as there were more work offers in harvesting pulses and beans. Moreover, access of landless laborers to credit increased in the form of advanced wages[4].

Due to export liberalization in 1988, export volume of rice and rice products rose from 134,000 metric tons in 1990-1991 to 182,000 metric tons in 2004-2005, while exports of pulses and beans increased significantly from 195,000 metric tons to 873,000 metric tons.

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[4] Okamoto, Ikuko, Agricultural Marketing Reform and Rural Economy in Myanmar; The Successful Side of the Reform, paper presented at the Parallel Session II, 2004,Institute of Developing Economies, JETRO

With the aim to expand cultivable land, private entrepreneurs and companies were allowed to reclaim vacant and fallow lands, virgin lands, and wetlands. The state also supports necessary machinery and equipment, manpower, fuel and communication network. In 2006, the total area of lands of private entrepreneurs and companies ready for cultivation reached 2.4 million acres, of which 0.7 million acres were reclaimed lands and 0.3 million acres were lands under cultivation. Accordingly, the net sown area increased by 1.5 times, from 19.9 million acres in 1988-1989 to 29.3 million acres in 2005-2006. Mixed and multiple cropping areas increased from 3.9 million acres in 1988-1989 to 19.8 million acres in 2006-2007[5].

Since agricultural infrastructure development was given priority, the number of dams and reservoirs increased to 659 in 2005-2006, from 475 in 1988-1989, which indicates that a total of 189 new dams and reservoirs were built in 2005-2006. Accordingly, irrigable area increased by 2.2 times, from 2.52 million acres to 5.52 million acres, resulting in an increase in irrigated area to 20.5 percent of cultivated land area from 12.6 percent.[6] Moreover, the total sown acreages of principal crops between 1988-1989 and 2005-2006 doubled. As a result, production of principal crops during the same period increased (see Table 2).

[5] Ibid., MNPED, Myanmar's Economic Development , November 2006

[6] Ibid.

Table 2: Changes in Sown Acreage and Production of Principal Crops

Crops	Production (in thousand metric tons)			Sown Area (in thousand acres)		
	1988-1989	2005-2006	Percentage Average Annual Growth Rate	1988-1989	2005-2006	Increase in Amount
Paddy	13,164	27,481	4.4	11,807	18,017	6,210
Beans and pulses	371	4,086	15.2	1,803	9,410	7,606
Oil crops	712	2,334	7.2	4,873	7,971	3,098
Cotton	60	236	8.4	443	820	377
Sugarcane	2,197	7,187	7.2	123	330	207
Culinary crops	389	1,810	9.5	327	852	525

Source: MNPED: Myanmar's Economic Development (2006).

Since 1992, the government has been implementing various reforms in the agriculture sector, including double cropping, which increased the number of paddies to 18 million acres in 2005-2006, of which 17 million acres were monsoon paddies and 0.6 acres are summer paddies. Thus, yields from paddies doubled during said period. There was also an increase in the yield of beans and pulses by 11 times during the same period. The growth rate of production of beans and pulses averaged 15.2 percent annually. And the yields of other crops were also increasing faster than domestic consumption. Thus, the progressive achievements in the agriculture sector covering production, services, and trade, accrue to national development efforts.

Livestock and fishery, subsectors of agriculture, are also important to Myanmar economy. These sectors contributed 9.5 percent in GDP in 2005-2006. Concerted efforts are being made for the development of livestock and fishery sectors to meet domestic consumption and to promote export. In Myanmar, fish production is still relatively untapped but has vast potential for advancements. Of the maximum sustainable yield of 1.5 million metric ton of freshwater fish and 1.05 million metric ton of marine fish, only 80 percent of freshwater fishery and 13.1 percent of marine fishery are being tapped at present.

2.2 Current Situation of Industry, Trade, and Investment

In industrial development, Myanmar's manufacturing sector accounted for slightly over 15.2 percent of GDP in 2005-2006 and employed approximately 12 percent of the country's labor force[7]. The main manufacturing activities are related to the processing of natural, mostly agricultural resources.

Food and beverages production accounts for about 75 percent of total industrial output. Private industries, though significantly contributing about 92 percent in the total industrial gross production, had in the past been confined to small-scale activities that mainly focused on agro-processing.

In order to promote industrial development, a total of 18 industrial zones were established across the country in 1995 and 2005. Altogether, 9,915 enterprises are operating in these zones. (Table 3; the distribution of industrial zones across the nation is shown in Map-1).

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[7] Statistical Year Book 2005, CSO, November 2007

Table 3: Dvelopment of Industrial Sector (December 2006)

Industrial Zone	21
Industries	9915
Private industries	43374
Cottage industries	8595
State-owned industries	799

Source: Chronicle of National Development (MOI) (2007)

Industrial enterprises can be classified into three types: state-owned, cooperative and private. Pattern of industrial sector has been significantly changed by the decreasing number of state-owned factories and the increasing number of private factories (Table 4).

Industrial development in Myanmar has never been vigorous. The development of small and medium enterprises, which play an important role in the industrialization of Myanmar, influences the progress of industrial zones.

To gain greater impetus in the industrialization process, the Myanmar Industrial Development Committee (MIDC) was formed in 1995. The MIDC's primary objective is to lay down policy measures. Other objectives of the MIDC are the following:

(1) Development of industries with agriculture as the base;

(2) Enhancement of quantity and quality of industrial products;

(3) Increased production of new types of machinery and equipment;

(4) Production of machinery and equipment for industrial use; and,

(5) Creation of suitable conditions for the shift to an industrialized state.

Table 4: Current Situation of SMEs in Myanmar

	1999	2000	2,001	2,002	2,003	2,004	2,005
Large	1,593	1,843	2,047	2,304	3,135	3,213	3,438
	(4.4%)	(5.1%)	0	0	0	0	0
Medium	4,033	4,185	4,291	4,342	6,215	6,359	6,430
	(11.2%)	(11.5%)	0	0	0	0	0
Small	30,410	30,201	31,393	31,852	33,454	33,863	33,456
	(84.4%)	(83.4%)	1	1	1	1	1
Total	36,036	36,229	37,731	38,498	42,804	43,435	43,324
	(100%)	(100%)	1	1	1	1	1

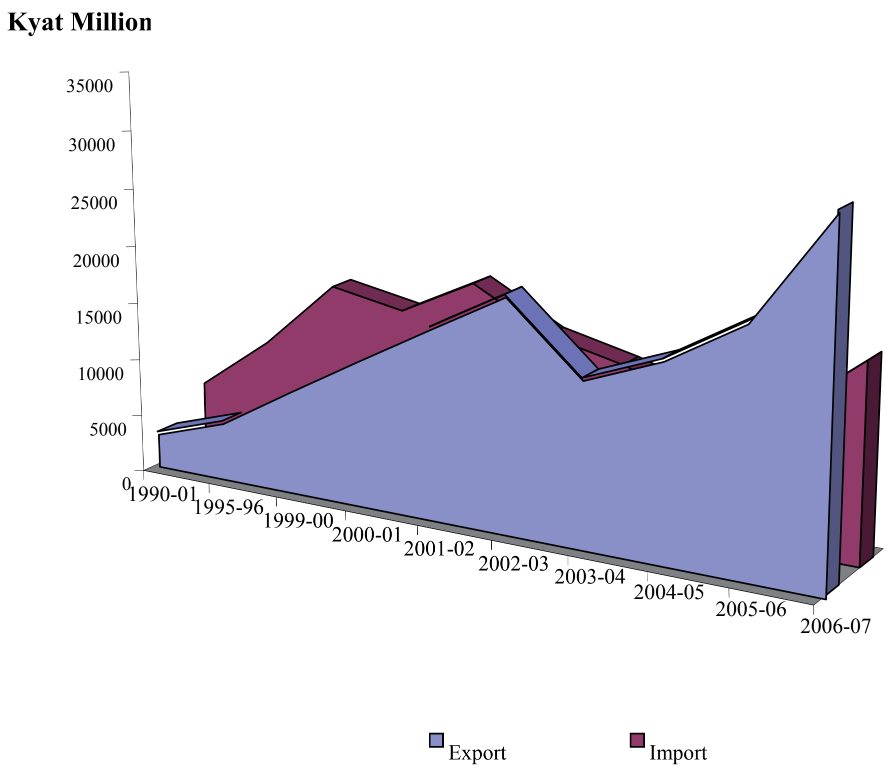
Source: Myanmar Industrial Development Committee (2007)

Through the support of government and the assistance of MIDC, advanced foundry and related workshops were established in industrial zones of Mandalay, Monywa, and Ayethaya (Taunggyi) to produce machine parts for the state organizations and local markets. Parallel to the establishment of advanced foundry shops, the government also assisted in the establishment of mould and die industry to support the manufacturing of high-quality machine parts. Indeed, setting up of advanced foundry and mould and die industries was a significant turning point and an important step for industrial development.

As to international trade, which is also in line with the market-oriented system, Myanmar's international trade performance got a boost when open economy and trade deregulation took center stage. As a result of the liberalization policy, the trade sector has grown steadily. Figure 3 shows the constant increase in the value of exports and imports, even as the balance of trade continued to have deficits until early 2000.

However, since 2002, there has been trade surplus due to the increase in total export volume and new export items in general and surge in natural-gas export in particular.

Figure 3: Changes in Value of Myanmar International Trade



The structure of export commodities obviously changed after 1999-2000. In the early 1990s, export structure was dominated by agro-based products. Later, resource-based products became the main export items. As shown in Table 5, agriculture products, mainly rice and pulse, contributed one-fourth of the total exports.

Table 5: Structural Changes in Export Commodities (Percentage Share)

No.	Commodity	1991-1992	1999-2000	2003-2004
1	Rice and rice products	5.8	0.7	0.9
2	Pulses	17.4	13.2	12.3
3	Maize	0.4	0.6	0.7
4	Oil cakes	0.4	0.0	-
5	Raw rubber	0.1	0.8	0.7
6	Raw cotton	-	0.1	-0.1
7	Raw jute	-	-	0.0
8	Other agricultural products	7.7	2.4	2.0
9	Animal products	0.2	0.3	0.1
10	Fish	1.2	2.6	2.3
11	Prawn	3.8	5.9	4.2
12	Other marine products	0.5	0.5	0.3
13	Teak	25.0	8.1	10.6
14	Hardwood	8.7	2.2	3.9
15	Base metal and ores	2.4	3.2	2.4
16	Silver	0.2	0.0	-
17	Precious stones and pearls	2.7	2.4	2.5
18	Gas	-	0.3	24.6
19	Garment	0.3	30.4	13.9
20	Other commodities	23.1	26.0	18.5
	Total Export	100.0	100.0	100.0

Source: Ministry of Commerce (2007)

Since 2003-2004, the new export product, natural gas, has been the major export item. It accounted for 24.6 percent of total export, followed by agricultural products, accounting 7 percent of the total. In 2006-2007, value of natural gas was the highest (55 percent) among the topmost export commodities, followed by forest and agricultural products, and garments (8 percent each).[8]

Meanwhile, the structure of importations remained unchanged. The majority of imports are dominated by capital goods, such as machines and transport equipment, contributing about 26 percent of total imports. Leading import item in 2006-2007 was refined mineral oil, which accounted for 32 percent of the total value of the top ten imported commodities. Other import leaders were machinery (23 percent) and nonmachinery and transport equipment (10 percent).

In accordance with one of the economic objectives, that is, developing the economy by inviting participation in terms of technical know-how and investments from sources inside and outside the country, the government enacted in 1988 the Foreign Investment Law (FIL). The law permits foreign investments and gives an opportunity to foreign companies to enjoy up to 100 percent ownership. And to stimulate investment from the domestic private sector, the Myanmar Citizen Investment Law (MCIL) was enacted in 1994. Along with these opportunities, joint ventures can be undertaken with either a private company or a state-owned enterprise. As a result, the inflow of FDI surged until the middle of 1996 but dropped sharply after 1997 partly due to the Asian economic crisis and partly due to the economic sanctions imposed on Myanmar by Western countries.

Under the FIL, 400 enterprises from 29 countries were permitted to invest in Myanmar, whose total investments were valued at US$13848.86 million as of end of September 2006. The permitted amount of investment since 1996-1997 is shown in Table 6.

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[8] MNPED, Myanmar's Socio-economic Development (2006-07)

Table 6: Yearly Permitted Amount of Investment

Year	**Amount, in Billion US Dollars**
1996-1997	2.814
1997-1998	1.013
1998-1999	0.054
1999-2000	0.058
2000-2001	0.218
2001-2002	0.019
2002-2003	0.087
2003-2004	0.091
2004-2005	0.158
2005-2006	6.066
2006-2007 (until September)	0.033
Total	13.848

Source: Ministry of National Planning and Economic Development (2007)

Most of the inflow of foreign investments came from Asian countries, followed by European countries and the United States. Among Asian countries, ASEAN+3 was the largest investor. The permitted amount of investment by source countries and the number of registered enterprises and businesses under FIL are shown in Tables 7 and 8.

Analyzing FDI by sector, it can be noted that electric power sector was the largest recipient sector of FDI in terms of volume, although there was only one investment made in this sector. The oil and gas sector takes the second spot in terms of the number of projects and invested value, followed by manufacturing, real estate development, hotel and tourism, and mining sectors. Most of the FDIs are resource-seeking and efficient-seeking, such as oil and gas, fishery, and garment industries due to the richness of natural resource endowments in the nation. Sectoral investment of permitted enterprises is shown in Table 9.

It is also noticeable that the domestic investment under MCIL increased annually, amounting up to Ks 125.34 billion in 2006. According to statistics, 669 enterprises have already been permitted under the MCIL. As to the number of projects and value invested, the largest player was the manufacturing sector, followed by real estate development, construction, and transport sectors.

Table 7: Permitted Amount of Investment by Source Countries

	Amount (in million US dollars)	Share (%)
Asian countries	**11,011.649**	**79.5**
-ASEAN+3	10,461.599	75.5
-ASEAN	9,860.787	71.2
-Japan	215.283	1.5
-China	194.221	1.4
- Republic of Korea	191.308	1.4
- India	35.075	0.3
- Others	514.975	3.7
European countries	**2,388.231**	**17.3**
-EU countries	23,79.599	17.2
- others	8.632	0.1
American countries	**3,33.897**	**2.4**
- United States	243.565	1.8
- others	90.332	0.6
Australia	**82.080**	**0.6**
Russia Federation	**33.000**	**0.2**
TOTAL	**13,848.857**	**100.0**

Source: Ministry of National Planning and Economic Development (2007)

Table 8: Number of Registered Enterprises and Business

	Enterprise	1990-1991	2000-2001	2004-2005
1	Exporters and Importers	5473	14121	18201
2	Business Representatives	282	2605	2774
3	Myanmar Company Limited	265	9596	14376
4	Partnership Firms	565	1264	1270
5	Foreign Companies and Branches	82	1410	1477
6	Joint-venture Companies Limited (excluding those under Foreign Investment Law)	16	64	66
	State-owned Economic Enterprises and Private Entrepreneurs	12	50	52
	State-owned Economic Enterprises and Foreign Companies	4	14	14
7	Joint-venture Companies Limited, formed under Foreign Investment Law	14	77	81
8	Other Organizations	6	39	41
9	Tourist Enterprises	-	601	700
10	Tourist Transport Business	-	423	378
11	Hotel Business	-	336	427
12	Lodging House Business	-	178	168
13	Tour Guide Business	-	5019	6327
	TOTAL	**3,923**	**35,797**	**46,352**

Source: Ministry of National Planning and Economic Development (2006)

Table 9: Foreign Investment of Permitted Enterprises

Sector	Permitted Enterprises (as of end September 2006)	
	Number	Approved Amount (in million US dollar)
Electricity	1	6,030.00
Oil and Gas	72	2,668.00
Manufacturing	152	1,610.41
Real Estate Development	19	1,056.45
Hotel and Tourism	43	1,034.56
Mining	58	5,34.89
Transport and Communications	16	313.27
Livestock and Fisheries	24	312.36
Industrial Estate	3	193.11
Construction	2	37.77
Agriculture	4	34.35
Other Services	6	23.69
TOTAL	400	13,848.86

Source: Ministry of National Planning and Economic Development (2007)

3. MECHANISM FOR ECONOMIC DEVELOPMENT IN MYANMAR

3.1 Development Strategies in Myanmar

Myanmar Development Strategy started with the most universal inward-looking development strategy since the early years of independence (1950- 1960). Myanmar, similar to other developing countries, practiced import-substituting industrialization led by the public sector during the socialist period (1962-1988). For external trade, a moderately high tariff wall was put in place to replace the free trade system of the colonial era. Although, the country's economy was based on agriculture, the socialist government gave priority to industrial sector development.

Since the military junta (SLORC) assumed power in 1988, Myanmar economy was transformed into a market-oriented economic system, initiating an *outward-looking development strategy*. Various efforts have been made to achieve sustained development for the economy. The most significant effort is the structural reform, which is considered as to be accompanied with stabilization programmes (especially monetary and fiscal adjustments) based on the following objectives:

- Adopt a market-oriented system for the effective allocation of resources and the distribution of goods and services;
- Encourage domestic private investments and entrepreneurial activities; and
- Open the economy to foreign direct investment and promote exports.

The main thrusts that direct the development strategies are envisioned towards the modern, development and peaceful nation with the three main national causes: nondisintegration of the union, nondisintegration of the national solidarity, and perpetuation of national sovereignty. With these guided national thrusts, four economic goals have been laid down as pillars for development strategies:

- Development of agriculture as the base and all-around development of other sectors of the economy as well
- Proper evolution into a market-oriented economic system
- Development of the economy that invites participation in terms of technical know-how and investments from sources inside and outside the country

- The initiative to shape the national economy must be kept in the hands of the state and people

3.2 Strategies towards Agricultural Development

For the development of agricultural sector, the Ministry of Agriculture, as a focal ministry, has adopted and implemented the following policies and strategies for agriculture development:

- To allow freedom of choice in agriculture production;
- To expand agricultural lands and safeguard the rights of the farmers; and,
- To encourage the participation of private sector in the commercial production of seasonal crops and perennial crops and the distribution of farm machineries and other inputs.

With a view to improve the agriculture sector and uplift the national economy, an agriculture policy was established in 1992, which declares the following:

- Production of food crops and industrial crops with no restriction;
- Permit the production of industrial and plantation crops on commercial scale;
- Allow private investors and farmers to expand agriculture production in cultivable wasteland;
- Encourage the participation of private sector in the distribution of farm machineries and other farm inputs; and,
- Utilize agriculturally unproductive land for other production programmes.

The policy objectives are:

- To achieve surplus in paddy production (*to increase rice production so that more surplus of rice could be exported after having reserved enough quantity for local consumption*)
- To be self-sufficient in edible oil production (*edible oil production in Myanmar is not sufficient and huge amount has to be imported annually. However, Myanmar plans to stop edible oil importation in the near future.*)
- To increase the production and export of pulses and industrial crops (*pulses are one of the major sources of protein and foreign exchange in Myanmar. Industrial crops include sugarcane, cotton, rubber, palm oil, of which cotton and sugarcane production is being intensified to increase export volume.*)

To achieve these goals in a more efficient manner, state-private harmonized approach and rural-welfare orientation approach are being carried out in the long-term. With a view to accelerate land development, the government has accorded strong administrative support to national companies, associations, and local citizens by encouraging and granting rights for the cultivation of paddies, pulses, oil crops, and industrial crops.

Specifically, Myanmar has five strategic approaches in implementing the policy, namely:

a. Development of new agricultural land;
b. Provision and adoption of agricultural machineries;
c. Provision of irrigation water;
d. Development and adoption of modern agro-technology; and,
e. Development and utilization of modern crop varieties.

In harmony with a market-oriented system, the government has made the most remarkable reform in the agricultural sector in 2003: the "Decontrolling of Paddy, Rice and Rice Product Trade", which mentions that the government will directly buy rice from farmers. This policy aims to ensure a free trade of the crop for the majority of rural farmers, in accordance with market-oriented policy. Within two decades, there was evident growth in the investments in agriculture infrastructure and the linkage between agriculture and industry had become stronger.

Functional and territorial aspects viewed as important factors for harmonious developments in agriculture, industrial, and infrastructure are taken into account in the strategies for development. Moreover, national unity, territorial integrity, special requirements and needs, challenging potentials, necessary reallocation/rehabilitation, and special plan of actions are covered under the territorial aspects of development. In order to accelerate economic growth, to achieve equitable and balanced development, and to reduce socioeconomic development gap between rural and urban areas, the National Development Plan comes with three national development programs, namely:

1. Development of Border Area
2. Build 24 Special Development Zones
3. Integrated Rural Development Plan

<u>Development of Border Area</u>

To ensure the equitable development all over the country, the programme was started in 1989. Specifically, the Ministry of the Progress of Border Areas and National Races and Development Affairs was established in 1992 to promote the well-being of border areas. The main task carried out by the Ministry is upgrading infrastructure in border areas to ensure greater connection with the other parts of the country and thereby narrow down development gaps. Until 2006, the programme was being carried out in 18 different areas covering 68 townships.

Plan for 24 Special Development Zones

To facilitate balanced socioeconomic development in all states and divisions, the government promotes education, health, and infrastructure advancement within the 24 Special Development Zones established in all states and divisions (illustrated in Map-2).

Integrated Rural Development Plan

More than 70 percent of the population live in rural areas in Myanmar and accordingly, national development will be delayed if improvements in these areas lag behind. In 2001, the Integrated Rural Development Plan was initiated to undertake the following major tasks:

- Construction of roads between villages in rural areas to establish a link with urban areas;
- Make water available for people as well as for cultivation;
- Improve and upgrade school buildings and furniture to improve the standard of education, to improve the quality of teachers, and to encourage school-age children to attend school;
- Uplift rural health care system; and
- Bring about economic growth for the rural populace.

With the objectives of enhancing economic development in Myanmar, the First Short-Term Four-Year Plan was implemented during the periods 1992-1993 to 1995-1996. It achieved an average annual growth rate of 7.5 percent.

The Second Five-Year Plan was also formulated and implemented from 1996 to 1997 and 2000 to 2001. This achieved an average annual growth rate of 8.5 percent.

The latest initiative, the Third Five-Year Short-Term Plan (covering the periods 2001-2002 and 2005-2006), achieved an average annual growth rate of 12.4 percent.

The main objectives of the Fourth Short-Term Five-Year Plan (2006-2007 and 2010-2011) are:

- To extend the establishment of agro-based industries and other required industries in building an industrialized nation;
- To develop the electric power and energy sectors to conform with the developing trends in industries;
- To develop agriculture, livestock, and fishery sectors in order to meet local demand for self-sufficiency and promote exports;
- To make initiatives to meet the targeted yield per acre of designated crops;
- To expand new cultivable lands for agriculture use;
- To set up a system that will fulfill the demand for edible oil and lubricant oil;
- To push for the utilization of biodiesel oil to supplement lubricant oil and fuel oil;
- To establish forest areas for greening;
- To conserve natural resources and protect the environment;
- To extend education and health support for human resource development;
- To build better roads and communication facilities in order to develop commerce and trade and establish friendly relations with other countries

- To continuously develop the infrastructure;
- To meet the set targets of the Special Development Zones;
- To carry on the development of border areas;
- To carry on the development of rural areas;
- To alleviate poverty;
- To exceed the targets of MDGs in implementing the national plans;
- To realize balanced economy and comprehensive economic development;
- To allow the good foundation of economic and financial condition to continue by means of the following:
  1. Retaining the momentum and the high economic growth rate;
  2. Strengthening the value of kyat;
  3. Reducing budget deficit to obtain surplus by the third year;
  4. Curbing inflation; and,
  5. Continuing the surplus of current account position in the balance of payment.

Moreover, to maintain sustainable development, the government adopted the Myanmar Agenda 21 in 1997 and ratified the UN Framework Convention on Climate Change and joined the Kyoto Protocol in 2003. Moreover, Myanmar put into operation efficient policies and strategies to keep in line with the United Nations' Millennium Development Goals, namely;

- Eradicate extreme poverty and hunger;
- Achieve universal primary education;
- Promote gender equality and empower women;
- Reduce child mortality;
- Improve maternal health;

- Combat HIV/AIDS, malaria, and other diseases;
- Ensure environmental sustainability; and,
- Develop a global partnership for development.

3.3 Development of SMEs in Myanmar

In Myanmar, the most distinguishing characteristics of the SME sector are: (1) it is composed largely of traditional micro and small businesses or enterprises (handicrafts, traditional weaving, pot making, etc), as well as small and medium manufacturing enterprises (food processing, oil production, cosmetics, soap and shampoo, herbal indigenous medicine, etc.); (2) it practices traditional production methods and techniques; (3) it is labor intensive and has low productivity, unable to meet local market demands.

Since the introduction of market-oriented policy in 1988, SMEs progressed vigorously. The enactment of the Private Industrial Enterprises Law of 1990 classified the industries, as shown in Table 10.

Table 10: Classification of Industries

No.	Category	Small	Medium	Large
1.	Power used (in horsepower)	3 to 25	Over 25 to 50	Over 50
2.	Number of workers	10 to 50	Over 50 to 100	Over 100
3	Capital outlay (in million kyat)	Up to 1	Over 1 to 5	Over 5
4.	Production value per year (in million kyat)	Up to 2.5	Over 2.5 to 10	Over 10

Source: Union of Myanmar Federation of Chambers of Commerce and Industry (2005)

To develop SMEs in Myanmar, the government promulgated the Cottage Industries Promotion Law of 1991. The promulgation of this law resulted in the registration about 600 cottage industries or micro industries, which employ less than 10 workers and utilize less then 3 horsepower of electrical power. In Myanmar, majority of the SMEs are in food and beverages production, followed by clothing and apparel, construction materials, household goods, printing and publishing, industrial raw materials, and agricultural equipment.

At present the Myanmar Industrial Development Committee (MIDC) has set up policy guidelines for the development of SMEs and the entire industrial structure, based on following framework:

(a) Development of Industries with agriculture as the base;

(b) Enhancement of quantity and equality of industrial products;

(c) Increased production of new types of machinery and equipment;

(e) Production of machinery and equipment for industrial use; and,

(f) Creation of suitable conditions for a shift to an industrialized state.

Existing institutions involved in the development of SMEs are shown in Appendix 2. Below is the list of organizations that are mainly responsible for SME development in Myanmar.

(a) Small-scale Industries Development Sub Committee (Myanmar Industrial Development Committee)

(b) Directorate of Industrial Supervision and Inspection (Ministry of Industry 1)

(c) Directorate of Myanmar Industrial Planning (Ministry of Industry 2)

(d) Myanmar Industries Association (Union of Myanmar Federation of Chamber of Commerce & Industry)

(e) Small and Medium Enterprise Committee (Myanmar Engineering Society)

Human resource development programmes for the development of SMEs are undertaken by government ministries (including the Ministry of Science and Technology, Ministry of Industry 1 and 2, Ministry of Cooperatives, and Ministry of Education) and nongovernmental organizations (NGOs), including Union of Myanmar Federation of Chambers of Commerce and Industry (UMFCCI), MES, etc. Among the NGOs, the UMFCCI is mandated to:

1. Cooperate and coordinate with the state in economic and social activities;
2. Enhance the competitiveness of Myanmar SMEs; and
3. Lead Myanmar business community in integrating into international trade and globalized economy.

Moreover, in order to promote SMEs, Myanmar also works with foreign agencies such as United Nations Development Programme (UNDP), JETRO, and Myanmar-Japan Association.

3.4 Initiatives for Sustainable Development

Myanmar is indeed very rich in forest resources. Forest covers about 50.81 percent of the total land area. Various types of forest exist according to the nation's climatic zones—from temperate to arid and tropical.

To conserve the forest and the natural environment, the government gives priority to efforts to protect the soil, biodiversity, plant/animal resources, scenic reserves, and national heritage sites. Sustainable management of the forest is also practiced simultaneously. It also employs the maintenance and rational use and enhancement of the forest resource base, to ensure continuous ecological resilience and contribution to socio-economic growth.

The government has reformulated and adopted the Forest Law in l992, Protection of Wildlife and Wild Plants and Conservation of Natural Areas Law in 1994, Myanmar Forest Policy in 1995 and Forest Rules in 1995. Moreover, the Department of Forest issued the Community Forestry Instructions in 1995 to promote community participation in forestry. In order to prevent desertification, a new institution, the Dry Zone Greening Department, was set up in 1997. The institution implemented the greening program for arid areas in Central Myanmar and Bago Yoma. Likewise, the National Commission for Environmental Affairs was established.

The forest policy of Myanmar was formulated according to the forestry principles adopted by the Union Nations Conference on Environment and Development. Myanmar Forest Policy will be implemented through six main activities, which comprise the following:

- Forest protection and conservation and management;
- Reforestation;
- Community forestry for local communities;
- Forest harvesting, processing, and marketing;
- Research and development, education, and trainings; and,
- Establishment and management of protected area system.
- Moreover, major elements integrated in the Forest Policy include:
- Food security;

- Rural development and viability of rural areas; and
- Environmental and social aspects.

As shown in Table 11, total forest area has increased about 4,000 square miles all over the country from 1998 to 2003 due to the massive efforts towards sustainable development.

Table 11: Distribution of Forest Covered Area by State and Division

(in Square Miles)

Year	Total Land Area	Forest Area			Other Land Area
		Total	Reserved	Unclassified Forest Area	
1998-1999	261,228	132,650	44,859	87,791	128,578
1999-2000	261,228	132,650	48,612	84,036	128,578
2000-2001	261,228	132,650	49,979	82,671	128,578
2001-2002	261,228	13,2861	53,992	78,869	128,367
2002-2003	261,228	13,6582	54,756	84,980	124,646

Source: Ministry of National Planning and Economic Development (2006)

3.5 Energy Security in Myanmar

Myanmar is well known for its rich natural resources, including renewable and nonrenewable resources (Table 12). Myanmar has a very high potential in the oil and gas and hydro-energy sector—this sector is the most attractive sector for foreign investment in Myanmar. Off-shore gas fields are operating under the production sharing contracts with foreign investors. There is, therefore, a lot of potentials in the establishment of downstream and related industries in this particular sector.

Table 12: Energy Resources in Myanmar in 2005

Sr.	Subject	Count	1988	2005
1	Oil Field (inland)	Number	19	18
2	Oil Field (Offshore)	Number	-	3
3	Gas Pipeline	Mile	250.91	1677.29
4	Crude oil production	Barrel	6,165,641	6,395,488
5	Gas Production	Cubic feet (in million)	41,913.97	371062.1
6	Refining Crude Oil	Gallon	156.461	230.796
7	Hydrogen Power Plan Implementing Projects a. Large Scale b. Medium Scale c. Small Scale Implementing projects, large scale	Number	14 (2) (1) (11)	44 (10) (10) (24) 20
8	Other Power Plants i. Recycling Power Plant ii. Boiler Power Plant iii. Natural Gas Power Plant iv. Coal Power Plant v. Diesel Power Plant (National Grid)	Number	- 3 8 - 588	4 3 11 1 567
9	Present Capacity for Generator	Megawatt	4,379.597	102.451
10	Future Capacity of Generator	Megawatt	273.755	5,599.345
11	Maximum Load	Megawatt	363.678	996.761
12	Electricity Consumption	Unit (in million)	1,517.570	5,461.089

Source: Ministry of Information, Chronicle of National Development (2007)

Hydropower is vital to electrification program for rural hilly regions. The untapped hydropower resources in Myanmar are estimated to have a total of 6421.4 MW and the present hydropower resources in Myanmar are estimated to be about 10 percent of the potential. Thus, Myanmar still has large renewable energy resources that can be used for electricity generation.

In Myanmar, electricity is also generated by using natural gas and diesel. The government also encourages the use of alternative sources of energy, such as solar and wind power, which have practically unlimited supply. The electricity consumption in Myanmar is still very low compared to other neighboring Asian countries, but the demand for electricity has rapidly increased since the introduction of market-oriented economic policy in 1988. The increasing manufacturing activities as well as the changes in modern lifestyle in Myanmar will continue to push up the demand for electricity. Therefore, the efficient use of energy and development of alternative sources of energy are crucial in Myanmar today.

Energy security is a vital part of the foundation on which a country's economy is built upon, especially for a country which has to depend on external supply of energy. Energy security consideration entails three distinct aspects:

- First is the need to maintain secure access to a strategically vital commodity. i.e. to ensure against energy disruption in order to protect the economy from external threat of interrupted supplies or infrastructure failure.
- The second concerns the leverage that oil producers may employ.
- The third stems from the power that oil wealth can bring to currently or potentially hostile oil producers.

In Myanmar, the most widely and commercially used nonrenewable energy are crude oil and natural gas. Exception for the limited joint ventures, oil and natural gas companies are state-owned. Most of the oil is produced on shore in 17 geological valleys; offshore production is undertaken in Rakhine, Gulf of Marta Ban, and Tanintharyi Division. The development of Myanmar's energy sector is presented in Table 13.

Table 13: Development of the Energy Sector of Myanmar

Subject	Count	1988	31-12-2006	Progress
• Oil field (Inland)	field	18	20	2
• Oil field (Offshore)	field	-	3	3
• Gas pipeline	mile	250.91	2,183.62	1932.71
• Crude oil production	barrel	6,165,641	7,663,236	1,497,595
• Gas production	cubic feet (million)	41,913.97	429,784.43	387,870.46
• CNG station	station	5	25	20
• Refining crude oil	gallon	156.46	219.9	63.44

Source: Ministry of Information, Chronicle of National Development (2007)

It is estimated that over 3000 million barrels of crude oil and more than 4 million cubic feet of natural gas are still deposited in the unexplored inland oil fields which have not yet been widely surveyed or searched. The unexplored offshore oil and natural gas are estimated to be about 100 million barrels and about 84 trillion cubic feet, respectively. In order to boost oil exploration and production, Myanmar Oil and Gas Enterprises (MOGE) has sought for foreign investment. Recently, 34 inland and 19 offshore joint venture agreements were signed and operations started in 11 inland and 12 offshore blocks. Myanmar has become a major exporter of natural gas within the region since 2000.

In Myanmar, electricity is generated mainly from four types of power sources: hydropower, gas, diesel, and thermal. There are eight types of transmission and distribution lines in Myanmar national grid systems. These include 230KV, 132KV, 66KV, 33KV, 11KV, 6.6KV, 3.3KV, and 0.4 KV lines.

To provide assistance to operators and managers of rural electrification projects, a manual for sustainable rural electrification using renewable energy was prepared, based on the development of the following three priority projects:

1. Small Hydro Electrification Plan in Heho of Nyaung Shwe Township
2. Mini Hydro Electrification Plan in Nan Lan Township
3. Lighting by rice husk gas engines in Sama Lauk village.

Economic growth target of the country requires a substantial expansion of the national power supply. Much emphasis is given to the development of the electric power sector because of its vital importance to the nation's social and economic developments. However, commercialization and privatization of the electric power sector still requires fulfilling the power demand of the country.

Myanmar has an abundance of hydropower potential of more than 100,000 MW and huge reserves of offshore natural gas. Development of hydropower involves big capital and longer lead time for commercial production. In order to meet future demand, hydropower has to be developed on long-term basis and gas turbine will have to be built to fulfill the current power demand. The abundance of hydropower enables Myanmar to consider development of hydropower projects not only for domestic power supply but also for export to the neighboring countries.

4. INITIATIVES FOR BRIDGING THE DEVELOPMENT DIVIDE TOWARDS ASEAN ECONOMIC COMMUNITY (AEC)

4.1 Initiatives for Economic Integration

Since early 1990s, the trend of the global economy has been shifting towards a more collaborative nature. Economic integration among nations is significant on regional and global scale, and most economies benefit from this process of integration.

To intensify economic integration, ASEAN countries, both the founding countries and the newer member-countries, have drawn up road maps for deeper integration, covering a broad range of issues such as elimination of tariffs and nontariff measures (NTMs), harmonization of customs procedures, standards and conformance, protecting intellectual property rights, as well as promoting logistic services, free flow of investments, movement of business persons, skilled labors and professionals, human resources development, and research and development.

Moreover, ASEAN has envisioned the ASEAN Economic Community (AEC) to be enjoying a free flow of goods, services, investments, and capital and skilled labor by 2015. The members of the ASEAN have a commitment to achieve these visions at national level.

Another development which contributed to the impetus for East Asian economic cooperation was the emergence of China as a powerful economic force, both in the regional and global scenes. To support the region's economic development, the ASEAN Free Trade Area (AFTA) was extended to the East Asia Free Trade Area (EAFTA), which consists of 10 ASEAN countries, China, Korea, Japan, India, Australia, and New Zealand. The realization of greater East Asian integration offers many opportunities as well as poses many challenges for countries in the ASEAN. The larger market resulting from greater trade integration will create greater demand for products, goods, services, and tourism.

Other initiatives, such as the Initiative for ASEAN Integration (IAI), Greater Mekong Sub-Region (GMS), Ayeyawady-Chao Pharya-Mekong Economic Cooperation Strategy (ACMECS), and BIMSTECS Initiatives, as well as the effort to provide financial and technical resources to assist CLMV, are being implemented. ASEAN+3 countries are also contributing resources to these projects as well as providing bilateral assistance schemes to CLMV.

Since 1988, the government of Myanmar has shifted towards outward-looking development strategy. Accordingly, Myanmar is actively cooperating with Asian and international economies. Myanmar's perspectives on economic integration can be viewed through the development policies in Myanmar, initiatives for promoting trade, the role of FDI in Myanmar's economy, industrial strategies, and promulgation of laws related to the economy.

4.2 Initiatives for Domestic Infrastructure Development

Indeed, geographical and communication factors play a significant role in the development of physical and economic relations between regions. Since the adoption of an open economy in 1990, Myanmar has realized the importance of infrastructure and made considerable progress in developing transportation, communications, and energy infrastructure to bring about a balanced and proportionate growth between regions and achieve solidarity of its citizens. Thus, infrastructure development has been carried out to achieve this goal.

However, the rural and border areas were underdeveloped due to insurgency and instability in frontier areas before 1988. After several negotiations and the state's efforts for regional development, a total of 17 armed groups joined the state for national integration. Since then, the state has fostered regional development projects in frontier areas. These remarkable achievements extended several national projects, including the Border Areas and National Races Development Project, Rural Development Projects, and Development of Special Zones, which are being implemented with the collaboration of government agencies, NGOs, and INGOs. Investments in major infrastructure development as percentage of total public investment are shown in Table 14.

Table 14: Public Investment in Major Infrastructure Development in Myanmar (% of Total Public Investment)

Year	Public Investment by Sector (%)					
	Production	Service	Infrastructure			Total
			Transport and Communications	Power	Subtotal	
1952/1953-1955/1956	34.2	35.1	20.6	10.1	30.7	100
1955/56-1959/1960	22.3	36.4	25.7	15.6	41.3	100
1962-1963	35.9	36.4	23.5	4.2	27.7	100
1974-1977	58.7	17.7	17.4	6.2	23.6	100
1978-1981	72.0	10.3	12.4	5.3	17.7	100
1987-1988	53.5	16.1	17.8	12.6	30.4	100
1990-1991	24.8	47.4	12.3	8.0	20.3	100
1999-2000	41.8	36.6	15.0	6.6	21.6	100

Source: Ministry of National Planning and Economic Development (2006)

Since 1988, the government has given emphasis to the expansion of highway network to narrow the gap between regions. Highways, such as the Union Highways and National Highways, have been constructed and upgraded. Construction of bridges across the major rivers Ayeyarwaddy, Chindwin, and Thanlwin are also being implemented under the Special Projects Implementation tasks (Table 15). New roads constructed across the nation during the period 1988-2005 reached a total distance of 22,451 miles. The upgrade of road network in urban and rural areas is shown in Table 16.

Table 15: Number of Bridges (1988-2006)

State/Division	Number of Bridges Constructed in 1988	Number of Bridges Constructed in 2006
Kachin State	27	45
Kayah State	6	8
Kayin State	8	13
Chin State	2	5
Sagaing Divisions	17	33
Taninthayi Division	8	15
Bago Division	36	55
Magway Division	20	38
Mandalay Division	18	32
Mon State	3	7
Rakhine State	11	48
Yangon Division	7	38
Shan State (East, South, North)	24	41
Ayeyawady Division	11	59
Total	198	437

Source: Ministry of Information, Chronicle of National Development Comparison between Period Preceding 1988 and after (2007)

Table 16: Upgrading the Road Networks (1988-2005)

Kind of Road	**Road Distance, 1988-89 (mile)**	**Road Distance, 2004-05 (mile)**
Rural		
Tarred road	280	1182
Graveled road	682	3957
Granite road	673	1,689
Earthen road	2,092	17,070
Total	3,729	23,900
Urban		
Tarred road	940	1890
Graveled road	724	997
Granite road	190	318
Earthen road	1,060	2,088
Total	2,915	5,295

Source: Ministry of Information, Chronicle of National Development Comparison between Period Preceding 1988 and after (2007)

The government is also expanding railroad routes. The number of railroad routes increased from 2,793.86 miles to 3952.9 miles (Table 17). With the participation of the private sector, the number of aircraft has increased from 10 in 1988 to 18 in 2005. The number of airports has been also increased to 38 from 21 during the same period (Table 18). The progress in development of telecommunication sector is illustrated in Table 19.

These progresses in the infrastructure sector can be considered as part of the border area development to narrow down the gap between regions and to build more confidence and understanding among the population.

Table 17: Progress in the Rail Transportation Sector

Subject	1988	2005
1. Railroad section		
(a) Railroad (mile)	2,793.86	3,952.90
(b) Station	487	780
(c) Bridge (large/small)	5,650	9,219
2. Engines and coaches		
(a) Steam engine	39	39
(b) Diesel engine	150	292
(c) Local train	26	N/A
3. Passengers and goods (in mil.)		
(a) Passenger	36.689	58.21
(b) Passenger per mile	1,870.125	2,604.360
(c) Goods	1.269	2.878
(d) Goods per mile	196.579	544.592

Source: Ministry of Information, Chronicle of National Development Comparison between Period Preceding 1988 and after (2007)

Table 18: Aircraft and Airport (1998 -2005)

No.	Subject	1998	2005
1.	Aircraft (Myanmar Airways)	10	13
2.	Aircraft (Private)	-	5
3.	Airport	21	38

Source: Ministry of Information, Chronicle of National Development Comparison between Period Preceding 1988 and after (2007)

Table 19: Developments in Telecommunication Sector (1988-2005)

	1988	2005
1. Post and Telegraph	1,428	1,814
(a) Post office	1,115	1,331
(b) Telegraph office	310	483
2. Telephone		
(a) Auto phone exchange	33	163
(b) Manual phone exchange	212	676
(c) Phone line	67,016	447,097
3. Mobile phone (quantity)		
(a) Cellular phone system	-	18,760
(b) Digital European Cordless Telecommunication system	30.1.97	2572
(c) CDMA system	17.10.97	12,041
(d) GSM Mobile system	12.3.02	58,442

Source: Ministry of Information, Chronicle of National Development Comparison between Period Preceding 1988 and after (2007)

4.3 Initiatives in Line with Regional Infrastructure Development

In the context of Myanmar regional cooperation with neighbouring countries, the government is implementing the Union Highways to facilitate linkages with the ASEAN and international communities. These are the following:

- ASIAN Highway
- ASEAN Highway
- Greater Mekong Sub-region (GMS) Highway
- GMS East-West Economic Corridor Highway
- GMS North-South Economic Corridor Highway
- BINSTEC Highway
- India-Myanmar-Thai Tripartite Highway

4.4 Related Issues

The challenges that the ASEAN came across with in the last decade have established the proof that the state and destinies of the Southeast Asian countries are interwoven with another and have shown how the way towards the AEC. They are in fact regional challenges that are transnational in scope.

These call for forging a stronger sense of unity in ASEAN and more engagement and cooperation for regional solidarity and cooperation. That is why the reaffirmation and acceleration of regional economic integration is seriously taken into account. Here economic integration means more than removing obstacles to trade—it means bringing economies closer together through infrastructure linkages at the highest level. To build the ASEAN Economic Community, ASEAN economic integration is vital.

Undoubtedly, Myanmar has shown its full participation in the regional integration process of ASEAN. The key measures undertaken include the following:

- Signing of Protocol for the Accession of the Union of Myanmar (1997);
- Signing of the Agreement on the Common Effective Prudential Tariff Scheme (CEPT) for ASEAN Free Trade Area (1997);
- Signing the ASEAN Agreement on Customs by ASEAN Finance Ministers (1997);
- Signing the ASEAN Framework Agreement on Services (AFAS) (1997);
- Adoption of Harmonized Commodities Description and Coding System (1997); and,
- Adoption of implementation strategies for the realization of ASEAN Investment Area in 2010.

The role of services in the ASEAN also has to be taken into account in the economic development in this region. The commitments of each sector under the ASEAN Framework Agreement in Services (see Appendix 3) have to given national treatment and expanded services liberalization beyond the scope of the GATS. To facilitate such commitments, Myanmar has to speed up its cooperation and efficiency efforts through the improvement of market access, as well as the diversification and facilitation of services suppliers, both within and outside the ASEAN region. Through an updated and comprehensive understanding of the market access opportunities under the said commitments, there are more concrete opportunities for Myanmar in service trade and investment.

Here remarkable initiatives taken by the government can be seen through the enhancement of the socio-economic life of rural folks and the fulfillment of the fuel requirements in the country via the plantation of physic nut oil for the energy sector. That is why cultivation of physic nut oil is given special priority; physic nut oil plays essential role in the production of biodiesel used to power up agricultural machines, generators, water pumps, and trailers. To obtain a comprehensive development for Myanmar, programmes, such as the 24 Development Zones for the Economics and Social Infrastructure and Rural Development based on five Rural Development Principles, are actively generating and promoting socio-economic life.

The concept of development and its challenges are moving to new directions as improving the quality of life and providing better education, higher standards in health and nutrition to reduce poverty, and adopting a richer cultural life and globalization. By overcoming the challenges, a new equilibrium may be sought between national sovereignty and the regional purpose of Southeast Asian community, after a close integration has been achieved. As ASEAN Vision 2020 is the signal that the ASEAN gives for a new integrated approach to regional economic cooperation, the challenges, prospects, and strategies for development should be a two-way linkage between peace and development. At the same time, Myanmar has issued mandates to step up their economic, social, and cultural development efforts for the welfare of the country and its people. Hence, being fully prepared for further challenges, Myanmar's participation in AFTA and possibly AEC is expected to lead the development of Myanmar based on its comparative advantage of abundant natural resources, its cheap but literate labor, and other strategic advantages like its location, which is near China and India.

5. POLICY IMPLICATIONS FOR MYANMAR ECONOMY

The 19 years dedicated to making a turnabout from the 1988 experience that is characterized by a lot of setbacks and poor performance of national economy for more than four decades, highlighting the "Growth-first strategy" is a primary concerns of the country. The Growth-first strategy calls for strong government with high mobilization force. To have community peace and tranquility and prevalence of law and order, which will lead to the stability of the state, the welfare of the community should be considered. In terms of reforms for building a new state, political renewals should bring about stability of the state, national reconsolidation, building a new nation in accord with the new state constitution.

Relative to the experiences gained through its legacy, the national development in the entire country can only be done if peace and tranquility are maintained. The aspirations to build a sustainable, strong, and modern nation can only be realized if there is national integration among the ethnic groups. National integration and sustainable progress of national integration attained by the present government are remarkable achievements. It has been envisaged that objectives, targets, and strategies elaborated with state interests are overwhelmed by the major reforms that have made in 19 years.

The designation of 24 development regions being pushed for regional prosperity is part of the improving parallel development in all regions. Throughout their length and breadth of area, the basic infrastructure development measures, such as the construction of roads, bridges, dams, and embankments, as well as facilitating requirements for health, education, and communications, have been extended under multinational projects. In fact, these developments can assure not only peace and stability but also nation-building endeavors, in which all members of the entire union take active participation. The legacy of the past gives many lessons and gives utmost importance to national thrusts, including national development.

The border area development projects give priority to the development of the regions where armed groups from national ethnic communities had returned to the legal fold. In a broader view of regional development, the state aims to ensure balanced and equitable growth in states and divisions, implement special projects in 24 special zones, and establishment of five rural development tasks, in addition to the projects for border areas and development of the ethnic groups. Moreover, the basic need for development of 43 remaining regions is placed under special projects division.

The overview of production of the manufacturing sector during the productive years and their structure form has led to sectoral development, fulfilling the requirements of the urban and rural areas as well as the border regions. By implementing the national tasks, the development of the manufacturing sector in fact uplifts the socio-economic life of the people. The tables in this chapter mention the overall picture of production and developments undertaken from 1988 to present.

Furthermore, the financial crisis in the region attributed to the initial financial turmoil in some Asian countries in 1997 and the sudden shifts in market expectations and confidence followed by regional contagion has provided many lessons to be learned. It is suggested that the extent and depth of the crisis should not be attributed to the deterioration in fundamentals but rather to the misrepresentations on domestic and international investors.

Nevertheless, Myanmar has to put forward a more realistic approach to be able to participate in the economic pole in the ASEAN region. Through its bilateral and multilateral engagements with overseas countries, feasible objectives, regardless of whether it is profitable or not, are necessary to promote economic relations with ASEAN in line with the bilateral agreements. A lack of experience in integration before 1988 and the historical setbacks in that year call for rapid achievements at national level and setting goals unhindered by economic gaps among its states and divisions. However, Myanmar,having the location advantage—it is located between two giant economies—can play an active role as a catalyst in achieving the economic pole in the region with ASEAN + 3 in the near future.

Because of the heterogeneity of the developing world, it will be wise for Myanmar to combine relevant concepts and theories from traditional economic analysis along with new models and broader multidisciplinary approaches derived from studying the historical and contemporary development experience of ASEAN, its immediate neighbors, and of East Asia. Myanmar's efforts to push the integration of regional economies and other forms of regional cooperation should be placed on a stable ground to earn investor confidence. The call of the hour in the global economy is transparency, and reliable statistics are recommended for business enterprises and financial institutions. To take stronger steps to hasten the AFTA process and draw investments into the nation, some policies have to be put place: to accelerate financial reforms and realign exchange rates which distort resource allocation; to promote the participation of SMEs in production and distribution networks in the neighboring countries by improving quality of products; to realize SEZs and FTZs (including industrial export processing zones); to enhance FDI and foreign exchange; and to take advantage of geographical location of the country between China and India by developing economic corridors. In the ASEAN context, national resilience means a degree of economic vigor, social cohesion, and cultural richness that help make a nation strong. That is why this collective commitment by the respective leaders of ASEAN is strongly supported by Myanmar as reinforcement for bringing about national prosperity.

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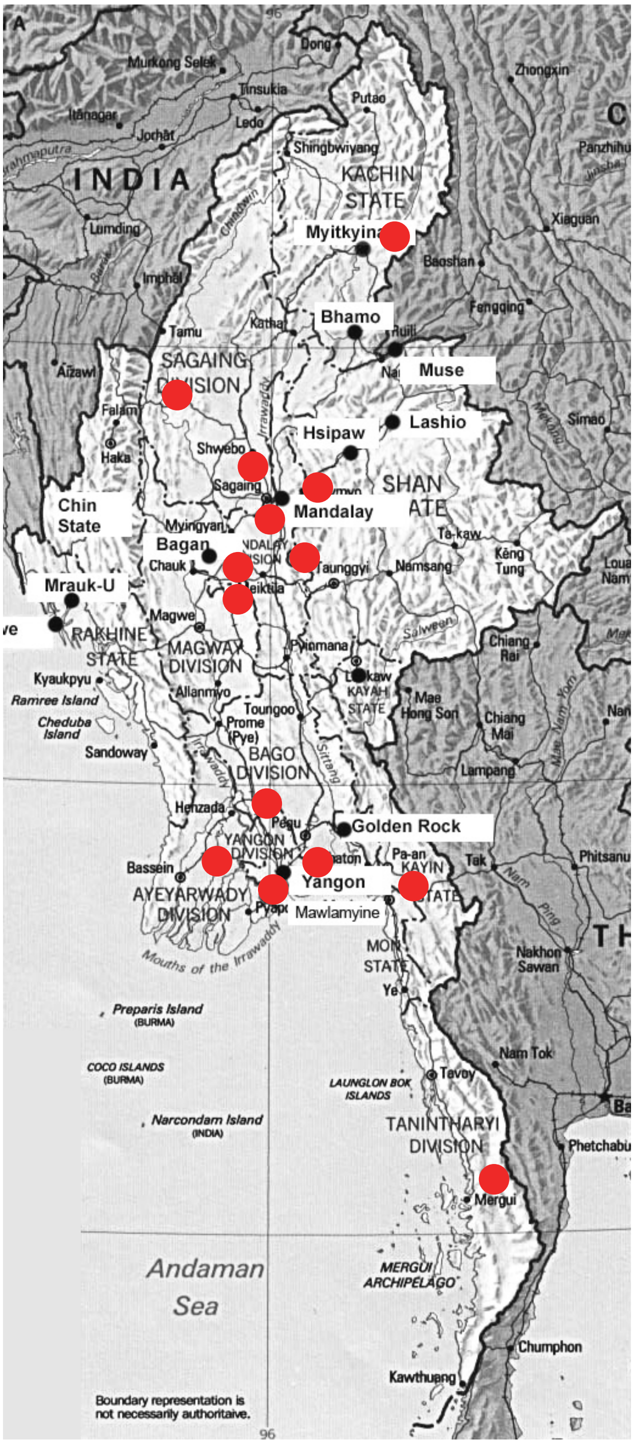
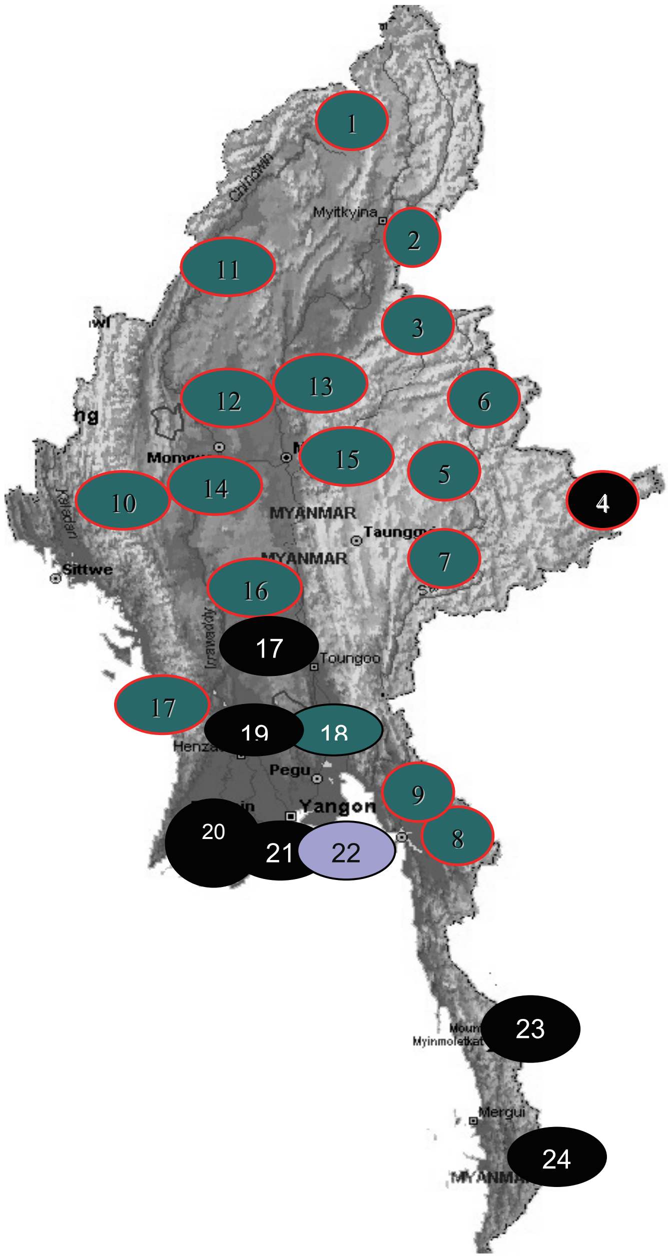
MAPS

Map 1: Industrial Zones of Myanmar



1. Mandalay
2. Myingyan
3. Meikhtila
4. East Yangon
5. West Yangon
6. North Yangon
7. South Yangon
8. Myaungmya
9. Hinthada
10. Pathein
11. Monywa
12. Kale
13. Pyay
14. Yenanchaung
15. Pakokku
16. Mawlamyaing
17. Taunggyi
18. Myeik

Map 2: (24) Special Development Regions in Myanmar



1. Myitkyina (Kachin State)
2. Bamaw (Kachin State)
3. La-sho (Shan North)
4. Kyang-Tong (Shan East)
5. Taunggyi (Shan South)
6. Pin-Lon (Shan South)
7. Lwai-Kaw (Kayah State)
8. Pa-an (Kayin State)
9. MawlaMyaing (Mon State)
10. Sittwe (Rakhaing State)
11. KaLay (Chin State)
12. Monywa (Sagaing Division)
13. Mandalay (Mandalay Division)
14. Pakhuku (Magway Division)
15. Maitthila (Mandalay Division)
16. Magway (Magway Division)
17. Pyay (Bago West)
18. Bago (Bago East)
19. Hinthada (Ayeyarwady)
20. Pathein (Ayeyarwady)
21. Ma-u-bin (Ayeyarwady)
22. Yangon (Capital Region)
23. DaWe (Taninthayi Coastal)
24. Myait (Taninthayi Coastal)

APPENDICES

Appendix 1: Chronology of Major Economic Reforms in Myanmar, 1987-2000

1987
- Participation of private and cooperative sectors in foreign trade
- Relaxation of government monopoly on the domestic marketing of paddy and some important crops

1988
- Removal of restrictions on private-sector participation in domestic and foreign trade
- Introduction of liberal Foreign Investment Law
- Restitution of small-and medium-size establishments

1989
- Decontrol of prices
- Official revocation of the 1965 law of establishment of socialist economic system
- Regularization of border trade
- Introduction of SEE law allowing private sector participation in economic activities
- Relaxation of restrictions on private investment
- Introduction of the Central Bank of Myanmar Law

1990
- Introduction of Myanmar Tourism Law
- Introduction of 100-percent retention of Export Earnings Law
- Introduction of Financial Institutions of Myanmar Law
- Introduction of Myanmar Agricultural and Rural Development Law
- Promulgation of the Commercial Tax Law

1991
- Announcement of the Central Bank of Myanmar’s Rules and Regulations
- Reestablishment of Myanmar Chamber of Commerce and Industry

1992
- Announcement to lease inefficient state-owned factories
- Announcement of denationalization of nationalized saw mills
- Announcement of the sale of government palm oil firms
- Announcement of the establishment of four private banks

1993
- Introduction of foreign exchange certificates (FECs)
- Announcement of the establishment of four more private banks
- Issuance of Treasury bonds with five- and seven-year maturity

1994
- Introduction of the Myanmar Citizens Investment Law
- Announcement of the establishment of three more private banks
- Announcement of licensing of representative offices of 11 foreign banks

1995
- Announcement of the privatization of 51 establishments
- Announcement of the formation of Privatization Committee
- Permission to establish joint-venture banks between local private banks and foreign banks

	● Opening of the foreign exchange center for free exchange of foreign exchange certificates
1996	● Permission granted to local banks to conduct foreign banking business and to pay interest on foreign currency deposits; basic reforms were introduced in 1989, many of which were delayed because of the political situation. Some significant reforms are highlighted in the following subsections.
	● Contract signed between Japan's Daiwa Group and Myanmar Economic Bank to establish a stock exchange company
	● Introduction of law on development of computer knowledge
1997	● Procurement of paddy through a tender bid system in November 1997, but the plan did not materialize and the requirement to sell paddy to the state has remained as usual
	● Joined ASEAN/AFTA
1998	● Leasing of fallow and virgin land for cultivation or livestock breeding by private farmers including foreign investors
2000	● Across-the-board increase of public sector wages and salaries by five to six times to align these with private sector remunerations
2006	Second across-the-board increase of public sector wages and salaries by five to 10 times to align these with private sector remunerations

Appendix 2: Existing Institutions Working on the Development of SMEs

Government	Private Sector
1. Myanmar Industrial Development Committee 2. Myanma Industrial Development Working Committee and Sub-committee 3. Industrial Zone Supervision Committee 4. Ministry of Industry No.(1) - Directorate of Industries - Industrial Supervision and Inspection Department 5. Ministry of Industry No.(2) - Directorate of Industries - Industrial Supervision and Inspection Department 6. Ministry of Science ad Technology -Myanma Science and Technological Research Department -Technological Transfer and Coordination Department -Atomic Energy Department -Higher Technological Education Dept. 7. Cottage Industries Department, Ministry of Cooperative 8. Ministry of Education - Human Resource Development Centers Arts and Sciences Academy Sciences and Technology Academy	1. Unions of Myanmar Federation of Commerce and Industry 2. States and Divisions Chamber of Commerce and Industry 3. Myanmar Rice Millers Association 4. Myanmar Forest Product and Timber Merchants Association 5. Myanmar Fisheries Federation 6. Myanmar Industries 7. Myanmar Printers and Publishers Associations 8. Myanmar Women Entrepreneurs Association 9. Myanmar Garment Manufacturers Association 10. Myanmar Computer Industry 11. Myanmar Pharmaceutical and Medical Equipment Entrepreneurs Association 12. Myanmar Construction Entrepreneurs Association 13. Myanmar Engineers Society 14. Myanmar Computer Science Association

Source: Union of Myanmar Federation of Chambers of Commerce and Industry (2006)

Appendix 3: Sector Commitments under the ASEAN Framework Agreement in Services

Air transport	Sales and marketing of air transport services, computer reservation, aircraft repair, maintenance, etc.
Business services	Information technology, accounting, auditing, legal, engineering, architecture, market research, etc.
Construction	Construction of commercial buildings, civil engineering, and installation works, etc.
Financial services	Banking, insurance, securities and broking, financial advisory, consumer finance, etc.
Maritime transport	International passenger and freight services, storage and warehousing
Telecommunications	Public telephones services, mobile phone services, business network services, data and message transmission, etc.
Tourism	Hotel and lodging services, tour operators, travel agencies, etc.

Source: ASEAN (2005)

Chapter 13

CHALLENGES, POROSPECTS AND STRATEGIES FOR CLMV DEVELOPMENT: THE CASE OF VIETNAM

Vo Tri Thanh

ABSTRACT

Since 1986, Vietnam has made numerous efforts to reform its economy, while proactive international economic integration is among the key complementary orientations. Vietnam has then achieved significant socioeconomic improvements since 1990, with sustained GDP and export growth, stabilized macroeconomic environment, rapid poverty reduction, and mobilization of large FDI inflows. Nevertheless, Vietnam is still facing many challenges, such as low competitiveness, limited quality of growth, low level of industrialization, and risks of macroeconomic and social instability. To realize its development objectives, Vietnam needs further reforms in some key dimensions, such as institutional reforms, improvement of macroeconomic policies, development of production factor markets, SOE reform and private sector development, adopting an appropriate integration roadmap, and confrontation of social costs.

1. INTRODUCTION

Despite enormous attempts for economic development throughout the South East Asian region, there remains a large gap between Cambodia, Lao PDR, Myanmar, and Vietnam (CLMV), and other ASEAN members. To realize the ambitious goal of having an ASEAN Economic Community (AEC) by 2015, it is essential to reduce this development gap, which in turn necessitates further reforms in the CLMV countries.

Vietnam has good conditions to progress in reforming itself. The process of economic reform initiated since 1986, with an important view to proactively engage in international economic integration, has brought about important socioeconomic 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 difficult task.

This paper attempts to shed light on the challenges to and prospects for development in Vietnam and aims to contribute to a broader strategy for enhancing development in the CLMV countries as a whole. To facilitate a better understanding of Vietnam's current stage of economic reform, the next section will briefly review the reform measures in the country since 1980s, with important reference to the process of international economic integration. In this light, the section following it will elaborate further by summarizing the main economic achievements, as well as remaining issues. Then, the penultimate section will discuss the major development goals and challenges for Vietnam in the coming years, particularly as the country is committed to further reforms and development. The final section will identify some key aspects for further reforms in Vietnam.

2. PROCESS OF REFORM AND INTERNATIONAL ECONOMIC INTEGRATION

Since its reunification in 1975, Vietnam has adopted bold measures to enhance economic rehabilitation and development. However, prior to 1980, the country remained under the centrally planned economic regime. Besides, the economy had been relatively autarkic, with only trade with the former socialist block.

Facing sluggish growth, Vietnam moved on to undertake reforms of its economy. Some microeconomic reforms were implemented, such as the contract system in rural areas, and the “three plans” for state-owned enterprises (SOEs) in 1981. These microreforms enhanced voluntary and decentralized interactions between individual agents and created new incentives for producers in raising outputs during the period 1982-85. As a result, Vietnam enjoyed a rather high rate of economic growth in the first half of the 1980s. However, there was not any significant change in macroeconomic management. Inflation became a serious problem and the failure of the so-called “price-salary-money reform” initiated in 1985 led the economy into crisis with hyperinflation.

In the aftermath of severe crisis and weaknesses in the outdated centrally planned economic regime, Vietnam started its *Doi Moi (Renovation)* process in 1986. The process has witnessed major changes in Vietnam’s ideology of economic management and development. For the first time, developing an economy of multicomponents was recognized as a vital need. Meanwhile, SOEs were given greater autonomy in making decisions on several aspects of business and production process.

Nevertheless, market-oriented reform package was for the first time implemented in 1989. Since then, the country has also pursued proactive trade liberalization and integration with the regional and world economy. Vietnam has been a signatory in an increasing number of bilateral and regional trade agreements, such as that with the EU in 1992, with the ASEAN in 1995, and with APEC in 1998, to name a few. The sector with foreign direct investment (FDI) has step-by-step become an integral part of Vietnam’s economy. Moreover, to effectively reap the benefits from trade liberalization and integration, Vietnam had to accelerate its domestic reforms, including structural and legal reforms.

In the years 1996-99, however, the process of economic reforms in Vietnam slowed down. This period also witnessed the economic crisis in a number of Asian countries, most of which are important partners of Vietnam. As a result, Vietnam focused more on demand-stimulus policy, and opted to delay its economic reforms until a better outlook was justified.

The period 2000-07 marked significant efforts of Vietnam to reform and to accelerate international economic integration. Specifically, the country has made further commitments to reforms, both explicitly under international agreements and/or arrangements, and implicitly as a complementarity to fulfill other obligations. Those commitments have been, nonetheless, implemented unevenly. For instance, the SOE reform in Vietnam progressed rapidly in the cases of small and medium enterprises (SMEs), yet was rather impeded when the country moved on to renovate large corporations. International economic integration also saw a major change, as the country more actively participated in bilateral and multilateral negotiation of economic agreements. The Vietnam-US bilateral trade agreement (VN-US BTA), signed in 2000 and in effect since late 2001, was the most comprehensive trade agreement ever to which Vietnam has been a signatory. The country undertook deeper commitments within the ASEAN Free Trade Area (AFTA) framework, and started to adopt full AFTA commitments in 2006. Vietnam became an official member of the World Trade Organization (WTO) in late 2006, with commitments to be implemented beginning January 2007. Vietnam also participated in other multilateral agreement such as the ASEAN-China Free Trade Area (ACFTA), ASEAN-Korea Free Trade Area (AKFTA), and others. Finally, it should be mentioned that the Party Congress X in 2006 and the new Government in 2007 have pledged commitments to further reform the national economy, with bold measures to curb corruption and accelerate administrative and SOE reforms, among others. The new Government is then expected to bring about a new wave of reforms, with more fruitful achievements, given higher public confidence.

3. ACHIEVEMENTS AND ISSUES

The reforms that Vietnam had been undertaking, particularly since the start of *Doi Moi* in 1986, has laid important and concrete foundations for economic growth and development in Vietnam. This can be reflected by the impressive performance that Vietnam has achieved in almost all aspects, from growth to structural changes and poverty reduction. The achievements have been more evident since 1990.

First, Vietnam in general has successfully retained stability of the overall macroeconomic environment. Inflation has generally been under control since 1990, except for some years when it was under high pressure. Meanwhile, fiscal deficit and external debt have also been under control.

Second, the economic growth has accelerated, from 7.2 percent per annum on average in the 1990s to about 7.5 percent per annum on average in 2001-05, with the peak of 8.4 percent in 2005. Growth then slowed down a bit, to just over 8.2 percent in 2006, before rising up high to an estimated level of 8.5 percent in 2007.

Third, economic growth in Vietnam has been accompanied by positive structural changes toward industrial production and services. As can be seen in Table

1, the share of agricultural production in GDP has been on the decline, from over 40 percent in 1991 to just under 25 percent in 2000, and slightly under one-fifth in 2007. This has largely been induced by the rise in relative importance of industrial production, including manufacturing. In fact, industrial sector went up as percentages of GDP from 23.8 percent in 1991 to 36.8 percent in 2000 and just over 42 percent in 2007. The shift toward service provision has been less apparent, as the share of this sector only went up modestly, from under 36 percent in 1991 to 38.7 percent in 2000, before decreasing slightly to just over 38 percent in 2007. The shifts in labor force were more evident. Agriculture still accounts for the highest share of labor, albeit declining from 73.3 percent in 1991 to under 55 percent in 2007. Services continued to attract more labor than the industrial sector, yet both of them accounted for larger shares of labor, of 25.7 percent and 19.6 percent, respectively, in 2007, compared with their respective shares of 14.3 percent and 12.4 percent in 1991.

Table 1: Contribution to GDP and mobilization of labor by economic sector.

	Agriculture	Industry *(manuf.)*	Services
% GDP			
1991	40.5	23.8 (13.1)	35.7
2000	24.5	36.8 (19.6)	38.7
2007	19.8	42.1 (21.6)	38.1
% Labor Force			
1991	73.3	12.4	14.3
2000	65.1	13.1	21.8
2007	54.7	19.6	25.7

Source: General Statistics Office (GSO) (Figures for 2007 are estimated).

Fourth, impressive economic growth has been significantly attributed to improvement in Vietnam's export performance. In the period 1990-2000, export growth of the country was dramatic, attaining 24 percent per annum on average. Increase in export somewhat decelerated in 2001, reaching only 3.8 percent. Since 2002, growth started to recover, rising continuously from 11.2 percent in 2002 to 19.1 percent in 2003 and 33.2 percent in 2004. After that, export grew at a slower pace, at 21.6 percent and 22.1 percent in 2005 and 2006, respectively, though the pace has itself been impressive in absolute terms. In the first year after its WTO accession, Vietnam successfully maintained high export growth, at an estimated level of 20.5 percent, and export value surged dramatically to USD 48 billion in 2007.

Fifth, together with Vietnam's view to develop the private sector and enhance its contribution to the national economy, FDI has been playing an integral role in Vietnam's socioeconomic development. The foreign-invested sector is contributing more and more to the national economy, as reflected by its share of 17.1 percent in GDP and of 57.7 percent in export (or approximately 36 percent if excluding oil) in 2006. Also, FDI presents another source of funds, together with hypothetical positive spillover effects, to support economic growth and poverty reduction in Vietnam. In 2006, FDI made up a share of 16.4 percent of total investment (Table 2).

Finally, the role of the domestic private sector has been continually enhanced and consolidated. The sector makes a sharply declining contribution to agricultural sector in terms of GDP, yet is accounting for an increasing export. Besides, the sector also contributed up to 33 percent of total manufacturing output. In another aspect, the private sector also became a major source of employment, absorbing as much as about 90 percent of about 1.3 million new labor market entrants each year.

Table 2: FIEs' contribution to VN economy.

	1992	1996	2000	2004	2005	2006
FIEs contribution to GDP (%)	2.0	7.4	13.2	15.1	16.0	17.1
Share of FDI in total investment (%)	22.0	26.0	18.0	15.5	15.7	16.4
Export by FIEs, excl oil export (USD mil.)	112	920	3320	8601	11,144	14,620
- Share of FIEs' exports (%)	5.3	23.4	22.2	33.1	34.4	36.9
No of employees in FIEs (1,000 persons)	n.a.	220	379	739	935	1,129

Source: Ministry of Planning and Investment (MPI).

The abovementioned economic achievements have enabled Vietnam to improve the social aspects of life for its people. Poverty incidence has been dramatically reduced, from 70 percent in the 1980s to 58 percent in 1993, 37 percent in 1998, 29 percent in 2002, and 14.7 percent in 2007. It should be mentioned that Vietnam has adopted a new (higher) poverty line since 2005, which further makes the progress in poverty reduction impressive. Human development, aggregating from improvements in life expectancy, education, and GDP per capita, also progressed, at least in absolute terms, though the improvements have been less impressive relative to other neighboring countries. In this sense, Vietnam has to a certain extent improved the set of choices available to its people, though further improvements are still required, particularly in their capability to exploit the benefits from those choices as well as newer ones.

Vietnam's socioeconomic achievements since 1990 can be attributed to four key factors. *First*, Vietnam officially acknowledges private ownership and rights of doing business for the private sector, including individuals, which induces profit-oriented economic activities on a market basis. *Second*, the country has pledged, and effectively implemented its commitments to market-oriented reforms, including liberalization of price regime, and structural reforms. *Third*, Vietnam has been proactively undertaking the "open-door" policy and international economic integration, via trade, investment, and other economic arrangements. These have brought about significant resources to supplement growth in Vietnam as well as exerted pressures for the country to carry out reforms. *Fourth*, the country has been successful in ensuring a stable macroeconomic and social environment, together with its growth process, which facilitates effectively economic activities and improvement of social life of the people.

It should be stated, however, that Vietnam's achievements are not outstanding, however impressive they may seem. Many weaknesses are still reflected, even in Vietnam's aspects of strong performance. Despite rapid growth in exports, the country lacks competitiveness. In terms of growth competitiveness index (GCI), the country was ranked very low by the World Economic Forum, at only 53/59 in 2000, 60/75 in 2001, 65/80 in 2002, 60/102 in 2003, 77/104 in 2004, 81/117 in 2005, and 86/125 in 2006.

Besides, the quality of growth has been under constant review these days, due to fears that the (inefficient) public investment is playing a too important role in driving growth than it should be. Foreign investments have been increasing, particularly in recent years, but the benefits from them, including the positive spillover effects via technology transfer, competition pressures, and linkages that they may bring, were not fully reaped. This is perhaps attributed to the lack of medium-sized enterprises. In fact, most private firms in Vietnam are small in size, and this has seriously hindered positive spillover effects of FDI. To add to the problem, disbursement of FDI has been rather slow, and actual contribution of the source to capital stock in

Vietnam is much less convincing than what appear from figures on committed FDI.

Moreover, the regional income disparity seems to be increasing. Despite nationwide reduction, poverty incidence persists at high level in the isolated and ethnic regions. Another phenomenon is the "new poor" referring to migrants and farmers who lost land in the process of industrialization and urbanization. Job training and retraining in these cases turned out to be insufficiently effective, and thus, new directions should be identified and pursued to deal with this group of poor people. In addition, income gap—both between rural and urban areas and within provinces—appears to have widened.

In another aspect, Vietnam is still at a low level of industrialization. Its manufacturing sector (as percentage of GDP in 2006) is relatively smaller than other East Asian countries in the 1980s and 1997/1998, while remaining comparable to those of other developing countries in the 1980s and 1997/1998 (Table 3). This observation is also reflected in the pattern of manufacturing industry by technological level. Even in 2006, Vietnam has a very high share of low-tech products in manufacturing output, roughly 73 percent, while high technology ones only account for a modest proportion of about 7.3 percent, i.e., far smaller than those of East Asian countries in 1980 and in 1997/98. The shares of manufacturing and hi-tech exports of the country in 2006, while being higher than those of other developing countries 10 years ago, remained significantly smaller than those of East Asian countries in 1997/98 (Table 3).

More generally, Vietnam has followed similar pattern of the regional linkages as other EA economies but only at the initial stage. As a result, firms in Vietnam are still at very weak positions, with low value-added content, in the global/regional

Table 3: Level of industrialization of Vietnam (preliminary assessment).

	East Asia		Developing Cs		VN
	1980	97/98	1980	97/98	2006
1. Manufacturing (% GDP)	31	31	20	20	21.3
2. % of manufacturing industry by tech. level					
+ Low technology	58 (73)	51 (69)	78	76	73.1
+ Medium technology	26 (20)	29 (21)	16	19	19.6
+ High technology	16 (7)	20 (10)	6	5	7.3
3. Man. exports (% of total)	45	82	23	39	39
+ hi-tech (% of total)	-	34	11	29	4.5

Notes: The data for East Asian countries are based on those of newly industrialized economies and ASEAN-4 (excluding Singapore; in brackets).

Source: Cited from CIEM (2007).

value chains, regardless of whether the chains are producer-driven or buyer-driven.

Together with greater involvement in international arrangements, Vietnam is facing greater macroeconomic and financial risks. After a long period of high growth, inflationary pressures have seemed to pile up, and the country has recently experienced rapid changes in consumer price index, by 9.5 percent in 2004, 8.4 percent in 2005, 6.7 percent in 2006, and 12.6 percent in 2007.

Meanwhile, what can be observed over the last two years is an expansion of the banking system and a “boom” of stock market coupled with rather massive capital inflows (Table 4 and Table 5). This appears to reflect some overexpectation of people about how the economy and firms are performing. In addition, there has been

Table 4: Some key indicators of Vietnam's stock market.

	2001	2004	2005	2006	2007
Market capitalization (%GDP)	0.3	0.5	1.1	22.8	43.0
VN-index	235 (peak=571)	241	307	752	927 (peak=1170 in March)
HASTC-Index	..	..	91.3	243	324 (peak=460 in March)
Number of listed firms - HOSTC/HOSE - HASTC	10 10 	26 26 ...	41 32 9	193 106 87	253 138 115
Investment funds	0	1	1	3	4
Securities companies	8	13	14	55	78
Investment management funds	..	?	6	18	25
No of investors' accounts - Institutional - Foreign	8,774 71 0	21,616 193 207	29,026 257 427	≈ 130,000 <500 1700	≈ 300,000 >500 >8000

Source: State Securities Commission (SSC) and other sources (end of the year).

Table 5: Vietnam's Balance of Payments.

(% GDP; unless otherwise indicated)

	1995	1996	…	2005	2006	2007
CA balance	**-12.6**	**-9.7**	**…**	**-0.9**	**-0.3**	**-3.1**
- Trade balance	-15.0	-12.6	…	-4.6	-4.6	-7.1
- Transfers (net)	3.0	4.8	…	6.4	6.6	7.4
K-A balance	11.1	11.6	…	5.0	7.4	15.0
- FDI	10.8	7.3	…	2.7	2.9	2.9
-L&M loan (net)	-1.2	0.4	…	2.6	1.9	2.1
- ST capital (net)	1.5	0.9	….	-1.9	0.5	2.2
Portfolio Inv			…	1.6	2.2	7.9
Off. reserves (US$ mill)	1,376	1,797	…	8,557	11,483	19,931
External debt (% GDP)	122.63	106.48	…	32.2	30.2	30.8
Debt services(%exports)			….	5.6	5.3	5.5

Source: Estimates based on data from IMF (various issues) (Figures for 2007 are projected) a tendency for banks to be "universal". The large corporations, mostly the SOEs, also attempt to expand their investment to a wide range of activities. While economies of scope remain to be seen, this raises a risk of further capital inefficiency, and if one fails, the effect to the financial system and/or the overall economy may turn out to be devastating.

Finally, there recently emerged signs of asset price "bubble" in Vietnam. The surge of capital flows, in the form of indirect investment, has increased the demand for the stock market, while there is a limitation on the proportion of shares held by foreigners and equitization of SOEs has been slow. Besides, a large amount of people's money is now diverted to the real estate market, which has to date pushed the price far beyond the intrinsic value. Together with a rather weak capacity to undertake financial supervision, these problems have given rise to some fear of asset price "bubbling".

In all, Vietnam can take pride in what it has achieved so far. Given its low starting point, with enormous difficulties resulting from the wars, the country has strived to start and accelerate socioeconomic development. Notwithstanding occasional failures, Vietnam has generally been on a right track of development. Weaknesses still remain, however, in a number of aspects, and are becoming clearer as the market economy in Vietnam is better shaped. Such weaknesses prevent any assessment of socioeconomic achievements in the country from being too outstanding, and necessitate further efforts to ensure its end.

4. DEVELOPMENT GOALS & MAJOR CHALLENGES

Given the quick pace that the world economy is changing, Vietnam has set some basic development objectives for the years to come. These objectives are ambitious, yet are by no means impossible for the country. Specifically, these objectives are to:

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 has basically achieved the status of "a modern-oriented industrialized country"; and
4. to materialize the slogan "Prosperous people, a forceful country, and an equitable, democratic and civilized society".

The objectives have reflected Vietnam's strong determination in developing itself, with significant attention to both economic and social aspects of people's lives.

There exist, however, enormous challenges to Vietnam in achieving these development goals. To begin with, the country is still in transition, with low income, and needs to strive for industrialization. Besides, weaknesses and even vulnerabilities persist in some critical areas, such as the SOEs, the financial system and efficiency of public investment, and others. As discussed above, firms and enterprises in Vietnam still lack competitiveness, and are mostly small or medium in size. More and more private firms are established, yet very few of them can become focal or leading ones in the field. Furthermore, the infrastructure is still underdeveloped. Infrastructure services and utilities like transportation and electricity remain too expensive and/or inefficient, resulting in high costs of doing business in Vietnam. Growth performance in the past year has been impressive, but to go further, Vietnam also needs better human and institutional capacity. Yet, it seems that the capacity is inadequate, which is highly attributed to the problems of public governance, and the quality of the education and training system. Finally, macroeconomic and social instability are still a threat, and have become more evident as a likelihood together with the country's deeper involvement in the regional and the world economy. Managing capital flows, avoiding wider poverty and income inequality, and reducing social risks and adjustment costs of trade liberalization and international integration are all but challenges that Vietnam needs to resolve on its way to sounder and more sustainable development.

5. KEY DIMENSIONS FOR FURTHER REFORM

With its limited resources, Vietnam is unable to deal with all issues, challenges, and weaknesses at the same time. It is advisable, thus, that the country identifies key dimensions to undertake further reforms. Many of them can easily be put in place, and have already been well-documented, yet only some are broad and urgent[1].

First, Vietnam needs decisive institutional reform to change the (still) state-led economic institutions into efficiency-enhancing institutions, with wider participation of its people. The legal framework should be improved to be better consistent with market-based economy and the country's commitments in international arrangements.

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[1] Some major parts in this section are taken from Bui and Vo (2007), Vo (2005), Vo and Nguyen (2006), and Vo et al. (2007).

Meanwhile, establishing an efficient and effective administrative and enforcement system should be given no less importance.

Second, Vietnam still needs enormous works to improve its macroeconomic policies, both in terms of formulation and enforcement. Regarding monetary policy, the State Bank of Vietnam should be *renovated*, to be a more modern and relatively independent central bank, while the money market should be developed with more monetary instruments available to both the central bank and market participants. Changes to fiscal policy are also necessary, on both revenue (income, asset taxes) and expenditure (public salary system, public bond-based investment) sides of the State Budget. More importantly, the need for an effective coordination between monetary and fiscal policy should be carefully addressed, to better facilitate growth and ensure macroeconomic stability.

Third, Vietnam should continue to develop markets for production factors, particularly in terms of institutions. In the land market, better clarifications and simplification of procedures are required with respect to ownership, registration, land clearance, asset/wealth tax, and others. Meanwhile, the supervision system needs improvement to better contribute to overall financial security, while development of institutional investors and bond market, especially one for corporate bond, should be given high priority as complementary measures to support capital market development. In the labor market, improvements are necessary for improving employer-employee relations, and for enhancing the role of labor unions, while the regulations on minimum wage and social safety net should be undertaken in a more systematic manner, with predictability.

Fourth, Vietnam should accelerate its SOE reform, development of private sector (especially SMEs), and attraction of efficient FDI with high technology and transfer of skills and knowledge. To begin with, the country should further reduce any antiexport bias that the incentive structure has created. Besides, work remains to be done to improve the overall business environment and to create a "level playing field", while reducing transaction costs for businesses. Instead of direct intervention into the economy in an administrative manner, the Government should be redirected to areas with high positive externalities to the rest of the economy, such as infrastructure, information, education, and training. To arrive at higher efficiency of the infrastructure projects, the participation of foreign and private firms in transparent public- private partnership schemes should be induced. The establishment of industrial zones with good master planning and appropriate support by local authorities (e.g., in land-site clearance) is also essential for business development.

Fifth, given its limited resource, Vietnam needs to identify and adopt an appropriate integration roadmap, rather than merely follow the current proliferation of free trade agreements. Having joined the WTO and other agreements, the country should first implement its commitments effectively. In addition, as a member of the ASEAN, Vietnam should continue to support and promote the ASEAN integration, especially the materialization of the AEC, as well as the East Asian integration in which the ASEAN plays a vital role. Vietnam can benefit substantially from participation in the East Asian network in manufacturing and tourism. In another direction, the country should work for appropriate cooperation with advanced economic partners, i.e., those with strengths in investment, technology transfer, and human resource development, among others. In this line, the forms of bilateral cooperation can go beyond the economic and trade arrangements.

Sixth, Vietnam needs to find itself appropriately positioned in the game to reap the benefits from a fast-growing China, as well as in the regional production network in order to avoid the so-called “low-cost labor trap”. There have been a number of opportunities for Vietnam to enter a “win-win” game with China. For instance, China has a huge market, with fast growth in economic size and consumption. Comprehensive cooperation commitments have also been enacted between Vietnam and China, both directly under the cooperation between the two countries, and indirectly under the framework of the ASEAN-China cooperation (including the Early Harvest Program between China and ASEAN) or the Greater Mekong Subregion (GMS) cooperation (“Two corridors and 1 belt”, “One axis, two wings”). Foreign investors also have high expectation of Vietnam’s growth prospects and many like to invest relying on the “China + 1” strategy.

Despite these, some concerns should be raised, particularly with the widening trade deficits of Vietnam against China (of over USD 2.8 billion and nearly USD 4.4 billion in 2005 and 2006, respectively) and with the pattern of “North-South trade” where Vietnam exports primary commodities to, and import manufacturing products and consumer goods from China. Unless some improvement is made, Vietnam may risk engaging in a low value-added part in the value chain, and accordingly enjoying rather low benefits from the regional production network.

Seventh, Vietnam should confront social costs in a determined manner and build up a social consensus. Encouragement of private sector development, particularly those of SMEs, is apparently a need, and can be undertaken via a range of measures, including facilitation of their access to formal finance. Besides, the country should establish its own social safety nets, with views to ensure the (minimum) living standard for the people and to ensure equity as it endeavors to get income tax from its people. Also, effective utilization of family and kinship supports may prove to be a good direction for Vietnam to pursue.

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