

## **Executive Summary**

# **DEVELOPMENT STRATEGY FOR CLMV IN THE AGE OF ECONOMIC INTEGRATION**

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## **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.