

## **Integrating the Mekong Region into ASEAN**

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**Paper for presentation at the Seminar on  
Accelerating Development in the Mekong Region – The Role of Economic Integration  
26-27 June 2006  
Siem Reap, Cambodia**

### **1. Introduction**

The focus of this paper is on the Mekong countries of Cambodia, Laos, Myanmar and Vietnam (CLMV). Since the mid-1980s, they have been undergoing economic transition, from central planning to market economy, from inward-looking to outward looking economic development strategies and policies, and from close economic relations with the Soviet-bloc to closer economic relations with market economies.

With the end of the Cold War and the break-up of the Soviet-bloc, Cambodia, Laos and Vietnam have been seeking integration into the global and regional economy. Membership in the WTO has been a long drawn out process, involving wide ranging reforms in economic policies and institutions and legal frameworks in CLV. Cambodia applied for WTO membership in December 1994 and finally joined the WTO in October 2004. Vietnam applied for WTO membership in January 1995 and is expected to join the WTO by end-2006. Laos applied for WTO membership in July 1997 and negotiations are still ongoing. WTO membership will enable these countries to receive non-discriminatory MFN status in international trade, a benefit enjoyed by WTO's 150 members. Myanmar is one of the founding members of the WTO in 1995.

Regionally, ASEAN was formed in 1967 and AFTA established in 1992. Vietnam acceded to ASEAN in 1995, Laos and Myanmar in 1997, and Cambodia in 1999. The CLMV countries also enjoy a positive regional effect in East Asia through two transmission mechanisms. First is the transfer of development experiences and lessons within East Asia, from Japan, the Asian NIEs and ASEAN, in particular following the ASEAN model of natural resource development and export-led and FDI-led manufacturing. The second is the flow of investment resources from Japan, the Asian NIEs and ASEAN-6 to CLMV, resulting in the integration of some Mekong economies into regional production networks and supply chains. Membership in ASEAN has facilitated the regional integration of the Mekong sub-region.

<sup>1/</sup> The views expressed in this paper are those of the author and should not be attributed to the International Monetary Fund, its Executive Board, or its Management.

Table 1: Basic Economic Data on ASEAN-6 and CLMV Countries

	Total area thousand sq km (1)	Population 2004 million (1)	GDP 2004 US\$million (1)	GDP growth rate			Merchandise trade 2004 US\$million (1)	GDP per capita 2004 US\$ (3)	GDP per capita 2004 US\$ppp (3)	Trade/GDP ratio 2004 %
				1980-1990 % (2)	1990-1995 % (2)	1996-2003 % (2)				
Brunei	5.8	0.4	5,181	na	na	2.0	13,879	25,243	127	
Indonesia	1,890.8	216.4	258,266	5.4	7.8	1.0	1,193	3,134	47	
Malaysia	330.3	25.6	117,776	6.0	9.5	3.4	4,625	9,857	188	
Philippines	300.0	82.7	86,407	1.7	2.2	3.5	1,042	4,482	89	
Singapore	0.7	4.2	106,884	7.3	9.1	3.6	25,207	24,853	340	
Thailand	513.3	64.5	163,525	7.9	8.6	1.5	2,537	7,488	116	
Cambodia	181.0	13.6	4,517	na	5.8	6.3	358	1,428	120	
Laos	236.8	5.8	2,439	6.0	6.4	5.9	423	1,896	41	
Myanmar	676.6	54.7	10,463	1.3	5.7	8.1	166	1,408	48	
Vietnam	330.4	82.0	45,277	5.9	8.2	6.7	554	2,491	122	
ASEAN-6	3,040.9	393.8	738,039				1,874	4,821	133	
CLMV	1,424.8	156.1	62,696				396	1,997	106	
ASEAN-10	4,465.7	549.9	800,735				1,454	4,020	131	
CLMV/ASEAN-10 (%)	31.9	28.4	7.8				27.2	49.7		

Sources:

(1) ASEAN Secretariat, ASEAN Basic Data

(2) World Development Indicators 2005

(3) ADB, Key Indicators of ASEAN Member Countries

Table 2: Intra-ASEAN Trade, 1993 and 2001-2002

	Value in US\$million			% of intra-ASEAN trade			% of country's trade	
	1993	2001	2002	1993	2001	2002	2001	2002
<b>Intra-ASEAN Exports by:</b>								
Brunei	487	775	684	1.1	0.9	0.8	21.9	25.4
Indonesia	4,997	9,507	9,934	11.4	11.3	11.5	16.9	17.4
Malaysia	12,987	21,024	22,127	29.7	24.9	25.6	23.9	23.7
Philippines	795	4,986	5,530	1.8	5.9	6.4	15.5	15.7
Singapore	18,406	32,815	33,963	42.1	38.8	39.3	27.0	27.2
Thailand	6,008	14,357	12,840	13.8	17.0	14.9	22.0	19.4
ASEAN-6	43,681	83,464	85,077		98.8	98.5	22.5	22.2
Cambodia	na	73	92	na	0.1	0.1	4.9	4.8
Laos	na	na	na	na	na	na	na	na
Myanmar	na	951	1,221	na	1.1	1.4	42.9	49.8
Vietnam	na	na	na	na	na	na	na	na
Total intra-ASEAN	43,681	84,488	86,391	100.0	100.0	100.0	22.8	22.5
As % of ASEAN total	21.1	22.8	22.5					
<b>Intra-ASEAN Imports by:</b>								
Brunei	886	545	599	2.3	0.8	0.8	41.6	37.4
Indonesia	2,659	5,727	6,932	6.9	8.5	9.6	18.5	22.2
Malaysia	8,904	15,254	17,245	23.0	22.6	23.9	20.9	21.9
Philippines	1,883	4,665	5,542	4.9	6.9	7.7	15.8	16.5
Singapore	18,761	28,991	30,441	48.4	42.9	42.1	25.0	26.2
Thailand	5,671	10,047	9,683	14.6	14.9	13.4	16.2	15.4
ASEAN-6	38,763	65,229	70,442	100.0	96.4	97.5	20.6	21.5
Cambodia	na	1,092	598	na	1.6	0.8	72.7	35.9
Laos	na	na	na	na	na	na	na	na
Myanmar	na	1,319	1,191	na	2.0	1.6	46.9	56.2
Vietnam	na	na	na	na	na	na	na	na
Total intra-ASEAN	38,763	67,640	72,231	100.0	100.0	100.0	21.3	22.0
As % of ASEAN total	17.4	21.3	22.0					
<b>Intra-ASEAN Exports and Imports:</b>								
Brunei Darussalam	1,374	1,320	1,283	1.7	0.9	0.8	27.3	29.9
Indonesia	7,656	15,234	16,865	9.3	10.0	10.6	17.5	19.1
Malaysia	21,891	36,279	39,372	26.6	23.8	24.8	22.5	22.9
Philippines	2,678	9,651	11,072	3.2	6.3	7.0	15.6	16.1
Singapore	37,167	61,806	64,404	45.1	40.6	40.6	26.0	26.7
Thailand	11,680	24,404	22,524	14.2	16.0	14.2	19.2	17.5
ASEAN-6	82,444	148,693	155,520	100.0	97.7	98.0	21.9	22.1
Cambodia	na	1,164	690	na	0.8	0.4	23.0	19.3
Laos	na	na	na	na	na	na		na
Myanmar	na	2,271	2,412	na	1.5	1.5	45.1	52.8
Vietnam	na	na	na	na	na	na		
Total intra-ASEAN	82,444	152,127	158,622	100.0	100.0	100.0	22.1	22.3
As % of ASEAN total	19.2	22.1	22.3					

Source: Chia 2005, Table 13

Table 3: CLMV - FDI Inflows from ASEAN Sources

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2001-2003
	US\$million									
<b>Cambodia:</b>										
from ASEAN							37.2	8.5	19.9	65.6
from World	151	294	168	243	232	149	149	145	87	381.0
ASEAN/World, %	na	na	na	na	na	na	25.0	5.9	22.9	17.2
<b>Laos:</b>										
from ASEAN	6.5	102.6	64.4	28.3	31.4	13.7	3.1	7.9	3.0	14.0
from World	88	128	86	45	52	34	24	25	19	68.0
ASEAN/World, %	7.4	80.2	74.9	62.9	60.4	40.3	12.9	31.6	15.8	20.6
<b>Myanmar:</b>										
from ASEAN	96.7	228.6	323.3	153.9	41.2	74.0	67.4	25.1	24.3	116.8
from World	318	581	879	684	304	208	192	191	128	511.0
ASEAN/World, %	30.4	39.4	36.8	22.5	13.5	35.6	35.1	13.1	19.0	22.9
<b>Vietnam:</b>										
from ASEAN	387.3	328.7	547.2	398.7	289.3	202.4	241.5	200.4	100.4	542.3
from World	1,780	1,803	2,587	1,700	1,484	1,289	1,300	1,200	1,450	3,950.3
ASEAN/World, %	21.8	18.2	21.1	23.5	19.5	15.7	18.6	16.7	6.9	13.7
<b>CLMV:</b>										
from ASEAN	490.5	659.9	934.9	580.9	361.9	290.1	349.2	241.9	147.6	738.7
from World	2,337	2,806	3,720	2,672	2,072	1,680	1,665	1,561	1,684	4,910
ASEAN/World, %	21.0	23.5	25.1	21.7	17.5	17.3	21.0	15.5	8.8	15.0

Source: FDI data from the ASEAN Secretariat website

## 2. CLMV Participation in ASEAN Economic Integration

### Progress in ASEAN Economic Integration

The ASEAN Free Trade Area (AFTA) was established in 1992 to enable ASEAN members become more internationally competitive in the face of pressures from globalization and regionalism in the Americas and Europe. It entails the removal of tariffs and non-tariff barriers on intra-ASEAN trade in goods. AFTA was followed by the ASEAN Framework Agreement on Services (AFAS) in 1995 and the ASEAN Investment Area (AIA) in 1998.

Critics point to the slow progress in ASEAN economic integration despite the introduction of numerous initiatives. The **McKinsey** study (2003) found that the many initiatives have had limited impacts, as seen in the following examples -----intra-ASEAN trade share has not grown with implementation of AFTA, unlike the case of NAFTA, EU or MERCOSUR; in 2000 less than 5% of intra-ASEAN trade made use of the AFTA tariff preferences; wide divergences exist in consumer prices of common household products in the region; economic complementarity, such as in the electronics sector, has not been well leveraged; and progress with removal of NTBs has been slow, particularly with regard to harmonisation of standards, implementation of mutual recognition agreements, (MRAs), and streamlining of customs procedures.

ASEAN's response is to realise the ASEAN Economic Community by 2020 (brought forward to 2015), in which there will be free flow of goods, services and skilled labour, and freer flow of capital. As laid out in the Vientiane Action Programme (VAP) for 2006-2010, activities to realise the AEC focus on 4 components --- (i) intensify current economic initiatives and accelerating the integration of 11 priority sectors; (ii) remove, as far as possible, barriers to the free flow of goods, services, skilled labour, and a freer flow of capital by 2010; (iii) develop measures to attract investments, liberalise and facilitate trade in goods, promote regional trade in services, upgrade the competitiveness of ASEAN SMEs, and strengthen the ASEAN dispute settlement system; and (iv) pursue strong external economic relations through FTAs and CEPs. As less developed and transitional economies, the CLMV countries are concerned that they have limited capacity to meet the challenges of accelerated liberalisation and integration.

Progress in AFTA, AFAS and AIA and economic cooperation are summarised below:

**(1) Trade in goods:** AFTA originally had a timeframe of 15 years to reduce tariffs to the 0-5 percent target range. The end-date was progressively brought forward to 2002 for the ASEAN-6, and set at 2006 for Vietnam, 2008 for Laos and Myanmar, and 2010 for Cambodia. AFTA has also since agreed to the zero-tariff level, to be achieved by 2010 for ASEAN-6 and 2015 for CLMV. For ASEAN-6, by January 2005, 99% of all products in the CEPT Inclusion List have their tariffs reduced to the 0-5% range, 64.2% have achieved zero-level tariffs, all CEPT products have been put into the Inclusion Lis, and the average tariff is down to 1.87% as compared to 12.76% in 1993. Notwithstanding the sharp decline in tariffs, intra-ASEAN share of ASEAN's total exports

remained stagnant, with 22.5% in 2004 as compared to 21.1% in 1993. Japan, US, EU, China and Korea remained ASEAN's main trading partners.

For CLMV, 87.2% of the products have been moved into the Inclusion List and tariffs on 71.05% have been brought down to the 0-5% level. Vietnam has moved all products while Laos has moved all manufactures into their Inclusion Lists, Myanmar has moved 98.74% into its Inclusion List, and Cambodia will move all products into its Inclusion List by 2007.

As tariffs come tumbling down in AFTA, more emphasis is being placed on trade facilitation, especially customs barriers, electronic processing of trade documents, harmonisation of product standards and technical regulations, and mutual recognition agreements, including for test reports and certification.

Eleven priority sectors have been identified for accelerated integration. The sectors are agro-based products, air travel, automobile products, e-ASEAN, electronics, fisheries, healthcare, rubber-based products, textiles and apparel, tourism, and wood-based products. Some of these sectors, such as fisheries, textiles and apparel, tourism and wood-based products, are those in which the CLMV sub-region has a comparative advantage. As compared to AFTA deadlines of 2010 and 2015, tariffs will be eliminated on 85% of the products in the priority sectors by 2007 for ASEAN-6 and 2012 for CLMV.

- (2) **Trade in services:** Services trade liberalisation under AFAS has been very slow and efforts are being made to accelerate it. Two flexibilities were introduced in 2003. First is the faster liberalisation for modes 1 and 2 (cross-border supply and consumption abroad), and slower liberalisation for modes 3 and 4 (commercial presence and presence of natural persons). Second, a "ASEAN minus X" formula allows two or more ASEAN countries to proceed first with services liberalisation, with other members joining at a later date.

MRAs are being negotiated to facilitate movement of experts, professional and skilled workers in ASEAN in engineering, architectural and accounting services, as well as nursing and medical practitioners. There are also measures to facilitate intra-ASEAN travel for ASEAN nationals and movement of business people, experts, professionals and talents.

- (3) **Investment liberalisation:** The AIA aims at making ASEAN a competitive and liberal investment area. In particular, it would allow investors to leverage on the various complementarities of the ASEAN region to improve business efficiency and lower costs and adopt regional business strategies and establish network operations. Originally confined to the manufacturing sector, investments under the AIA are now open to manufacturing, agriculture, mining, forestry and fishery sectors and only services incidental to these sectors. ASEAN members are committed to gradually eliminate investment barriers, liberalise investment rules and policies, and grant national treatment and open industries to ASEAN investors by 2010 and to all other foreign investors by 2020. However, there are sensitive lists and temporary exclusion lists to the granting of national treatment and opening up of industries and sectors to foreign investments. The end-dates for phasing out the TEL in manufacturing are set at January 2003 for

ASEAN-6 and Myanmar, and January 2010 for CLV countries. The end-dates for phasing out the TEL in the other designated sectors are set at January 2010 for ASEAN-6 and Cambodia, 2013 for Vietnam, and 2016 for Laos and Myanmar.

(4) *Regional economic cooperation* is also pursued in various sectors and areas such as SMEs, energy, food, forestry and agriculture, IP, minerals, statistics, telecommunications and IT, tourism and transport.

### **CLMV's Global and Regional Integration Through Trade and Investment**

**Table 1** shows the global trade integration of CLMV countries. Vietnam has the largest volume of trade, followed by Myanmar and Cambodia, while Laos has a very small external trade. Trade integration, as measured by the trade/GDP ratio is very high (over 100%) for Cambodia and Vietnam, but is less than 50% for Laos and Myanmar, the latter reflecting Laos' position as a land-locked state and Myanmar's international isolation because of its domestic politics. The trade ratios have risen significantly since 1990, from 18% to 120% for Cambodia, 30% to 41% for Laos, 6% to 48% for Myanmar, and 80% to 122% for Vietnam.

Up to the early 1990s, the CLMV countries were heavily dependent on exports of primary products. Cambodia, Laos and Myanmar have been transformed from being exporters of various primary commodities to exporters of clothing (HS61, HS62), the latter accounting for 85.5% of Cambodia's total exports, 77.5% of Laos' total exports, 39.5% of Myanmar's total exports in 2002.

The external trade of the CLMV sub-region has shifted from the COMECON socialist countries towards US-EU. For Cambodia, the US and EU accounted for 84% of total exports in 2002, with the exports dominated by clothing and footwear (Chia, 2005). The expansion in Cambodia's textiles and clothing exports since 2000 is due largely to favourable quota allocations and MFN tariffs from the US, following the 1999 US-Cambodia bilateral agreement. For Vietnam, the export share of US expanded rapidly following the 2001 US-Vietnam Bilateral Trade Agreement (BTA).<sup>1</sup> For Laos, the export share to the US remained low but there was a quantum leap in the export share to the EU. There were also quantum leaps in Myanmar's export shares to the US and EU. The sharp growth in CLMV exports to the US and EU is in sharp contrast to those experienced by the ASEAN-6.

The CLMV countries, particularly Vietnam and Myanmar, are beginning to be plugged into the East Asian production networks for electronic products and components. There are good prospects for relocation of investments from the more advanced economies in East Asia as Vietnam and Myanmar have abundant low-wage labour and as investors seek to diversify dependence on China. However, the electronics industry is extremely time-sensitive, and Vietnam and Myanmar will need to reduce risks of

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<sup>1</sup> The BTA commits Vietnam to reduce import tariffs and quotas, reform customs system and procedures, liberalise trade in services, liberalise foreign investment, liberalise trading rights, upgrade commercial dispute settlement procedures, enhance intellectual property rights protection, and grant MFN and national treatment to US companies and nationals.

supply disruptions, and improve the skills base and transport and logistics infrastructure to become production and export nodes.

CLMV trade with ASEAN has not grown as dramatically as with the US-EU since joining ASEAN. As shown in **Table 2**, in 2002, intra-ASEAN trade accounted for only 4.8% of Cambodia's exports and 35.9% of its imports (there are no comparable figures for Laos and Vietnam). Myanmar is much more integrated with intra-ASEAN trade accounting for 49.8% of its exports and 56.2% of its imports, reflecting the country's political isolation by the western powers. Myanmar exports to ASEAN comprise largely of mineral fuels (largely crude), forestry products and vegetables, while its imports comprise largely of mineral fuels (refined petroleum), textiles and clothing, machinery and electrical appliances, and plastics. **Austria's study (2004)** on the ASEAN priority sectors, shows ASEAN is a significant market for CLMV exports, ranging from 42% for Vietnam to 76% for Laos. Agro-based and wood-based products accounted for the largest share.

WTO accession is expected to bring substantial trade and FDI benefits to Cambodia, Laos and Vietnam. First is the MFN market access. Non-membership has subjected Cambodia, Laos and Vietnam to discriminatory treatment of their exports in various global markets, particularly the US market. Vietnam had to be subject to the annual waiver, and "normal trade relations" (NTR) was finally achieved with the signing of the US-Vietnam Bilateral Trade Agreement (BTA) in July 2000 after a 4-year negotiation. The US granted NTR status to Cambodia in 1997 and to Laos in 2004. Second, accession means the countries can turn to the WTO dispute settlement mechanism to defend their trade interests. With falling tariffs and quantitative restrictions in the WTO, importing countries increasingly resort to the use of technical barriers to trade (particularly SPS standards) and antidumping measures to protect domestic interests. Third, WTO membership is forcing the CLV countries to undertake and accelerate domestic reforms initiated since the early/mid-1980s --- the legal framework and transparency of rules, regulations and practices governing administration, trade and investment and state-owned enterprises. These should serve to improve economic efficiency and lower business transaction costs. Fourth, the CLMV countries are beneficiaries and potential beneficiaries of the WTO's special and differential treatment for developing and least developed countries.

The CLMV countries show a growing FDI penetration as measured by the FDI stock/GDP ratio, with the highest ratio in Vietnam, followed by Cambodia and Laos. These stock ratios are higher than some of the ASEAN-6 countries despite the more recent history of FDI in the sub-region. However, in absolute amounts, the CLMV received considerably less FDI than the ASEAN-6. Apart from a less favourable investment climate, FDI inflows were adversely affected by the Asian financial crisis of 1997-98, and for Myanmar by the restrictions imposed by the US and EU. As shown in **Table 3**, data on intra-ASEAN FDI for the period 1995-2003 shows a declining share of FDI from ASEAN in the post-financial crisis years. Dependence on investments from ASEAN during 2001-2003 averaged 15.0% for the CLMV sub-region, and ranged from 22.9% in Myanmar (mostly Singapore and Thailand), to 20.6%



in Laos (mostly Thailand and Malaysia), 17.2% in Cambodia (mostly Singapore and Malaysia) and 13.7% in Vietnam (mostly Singapore, Malaysia, Thailand).

Two factors impact on FDI prospects for the CLMV sub-region. First, while these countries have abundant low wage labour (especially Myanmar and Vietnam), they are handicapped by the legal and regulatory framework, shortages of skills, lack of local suppliers of parts and components, and transportation and logistics inefficiencies. These countries will have to hasten the process of economic integration into ASEAN. Second, the sub-region faces formidable competition for regional and global FDI from China, which has a much larger domestic market and pool of low-wage labour as well as availability of skills and infrastructure. There is recent evidence, however, that investors are attracted to the Vietnam location to avoid putting all their eggs in the China basket. WTO membership should further improve Vietnam's attractions for FDI.

### **Impact of ASEAN Membership on CLMV Economies**

ASEAN enlargement to include the CLMV countries achieved the political objective of overcoming the historical Cold War divide in Southeast Asia. However, enlargement also meant that ASEAN had to face new challenges of dealing with different political and ideological outlooks and external relations (particularly between Myanmar and the US and EU). On the economic front, CLMV membership has slowed the pace of ASEAN economic integration, as the transitional economies have to be given extra time and greater flexibility to fulfil their trade and investment liberalization commitments. The CLMV membership did not considerably expand the AFTA market. As **Table 1** shows, although accession added 156.1 million or 28.4% to ASEAN's population, it added only US\$62,696 million or 7.8% to ASEAN's GDP in 2004.

Theoretically, membership in ASEAN is expected to bring several economic benefits for the CLMV economies, enabling them to diversify and upgrade and respond more effectively to the challenges of globalisation, the technological revolution, and the rise of China.

- First, the CLMV countries have preferential access to the ASEAN regional market, enabling them to have greater market security, specialise according to comparative advantage, exploit scale economies, and improve the prospects for attracting FDI. As noted earlier, Cambodia (until October 2004) Laos and Vietnam are not WTO members and do not enjoy MFN treatment for their exports. ASEAN offers preferential market access, and production for a larger regional market would improve economic efficiency. Trade liberalisation in ASEAN also introduced the dynamic effects of increased competition and transfer of technological and management skills through FDI.
- Second, integration into ASEAN provides opportunity to leverage economic complementarities between CLMV and the more advanced ASEAN countries. With abundance of agricultural, marine and mineral resources and low-wage labour, the CLMV economies have comparative advantage in primary-resource-based activities and labour intensive manufacturing. Technical assistance is necessary to raise SPS standards in food processing to meet demands in the regional

and global markets. Relocation of labour-intensive manufacturing products and processes from the more advanced ASEAN economies would enable the CLMV countries, particularly Myanmar and Vietnam, to be integrated into the regional production networks and industry clusters, but the low wage advantage has to be accompanied by improvements in productivity and transport infrastructure and logistics for just-in-time and time-sensitive manufacturing.

- Third, ASEAN membership increases the attractiveness of the CLMV sub-region for FDI in resource processing and labour intensive manufacturing. In particular, Vietnam's geographic proximity to China, large population, competitive labour costs and membership in a stable ASEAN region makes it an attractive alternative investment destination for investors wishing to diversify investment risk. Also the joint development of tourist infrastructure and common marketing of ASEAN as a tourist destination have benefited CLMV tourism.
- Fourth, CLMV countries could learn from the best practices in economic development and economic management of the more advanced ASEAN countries. In particular, in the transition from command to market economies and from economic isolation to economic opening up, CLMV could draw on the expertise and experience of the more advanced ASEAN countries, and not rely solely on the international and regional development and financial institutions. CLMV countries could also access more technical assistance, including customs harmonization and procedures, technical and sanitary and phytosanitary standards, setting up of test labs, as well as capacity-building measures such as training of government officials.
- Fifth, ASEAN membership could put further pressure on CLMV to pursue necessary domestic economic, institutional and regulatory reforms, in addition to those required for WTO membership.

Implementation of AFTA/AFAS/AIA /AEC agreements and obligations also poses costs and concerns for the CLMV sub-region. A primary concern is the loss of customs revenue from the removal of import tariffs on intra-ASEAN trade. The **McKinsey study (2003)** noted that customs duties as a share of total tax revenue in CLMV in 2001 ranged from 35% in Cambodia, to 23% in Vietnam, 16% in Myanmar and 11% in Laos. Technical assistance is required to enable these countries to improve tax collection efficiency and explore alternative sources of government revenue. Another major concern is the social cost of restructuring uncompetitive industries and the state enterprise sector. As with most ASEAN-6 countries, the CLMV countries lack formal social safety nets to deal with structural unemployment. There is also concern that economic integration will cause the CLMV countries to fall further behind the other ASEAN economies as manufacturing production may be drawn away from the CLMV to the more advanced economies in ASEAN. A further concern is that services liberalisation under AFAS would touch on politically sensitive and strategic sectors such as telecommunications, financial services, transportation and utilities, many of which are monopolised by inefficient SOEs and governments are under tremendous pressure to protect them. Additionally, as skilled labour is crucial to comparative advantages in the services sectors, there is concern that services trade liberalisation would marginalize the CLMV countries and widen the income

gap between them and ASEAN-6. There is also concern that preferential access for ASEAN service providers would later preclude the entry of more efficient global service providers.

### 3. Narrowing the Development Gap

#### The Development Gap

When the CLMV acceded to ASEAN in the late 1990s, there was considerable concern over the emergence of a “two-tiered ASEAN” because of the wide disparity in development and income levels. The sharp differences in per capita incomes between the ASEAN-6 and the CLMV are shown in **Table 1**. The average nominal per capita GDP in 2004 for CLMV is US\$396 as compared to US\$1,874 for the ASEAN-6. The ppp-adjusted per capita GDP gap is narrower, with US\$1997 versus US\$4821. However, it should be noted that there is also a wide disparity in per capita GDP among the ASEAN-6 and the development gap between Indonesia and Philippines and the CLMV countries is much narrower than among the ASEAN-6. Furthermore, in the 1996-2003 period, the CLMV countries have achieved faster GDP growth rates than the ASEAN-6 countries. However, while faster growth will lead to a narrowing of the development gap in relative terms, the absolute gap can only be narrowed with sustained high growth for CLMV.

There is concern that, as low income and least developed economies, the CLMV may not be able to exploit the opportunities of economic integration in ASEAN. They need the capability to maintain a competitive business environment and economic and social development in order to participate effectively in both regional integration and globalisation processes. More direct government interventions at the national and regional levels are required to narrow the gap.

#### ASEAN Efforts to Narrow the Development Gap

The challenge of economic integration would be lessened for the CLMV sub-region with targeted technical assistance from the ASEAN-6. In the immediate years following the CLMV accession, the ASEAN-6 economies were pre-occupied with pulling their economies out of the 1997-98 Asian financial crisis. Since then, there is a greater sense of commitment to ensure that the CLMV countries are not left behind in economic development. The *Hanoi Declaration* on Narrowing Development Gap for Closer ASEAN Integration of 2001 noted that the development gap would be further widened without effective measures. The *Declaration of ASEAN Concord II* in October 2003 reaffirmed the commitment: “The ASEAN Economic Community shall ensure that the deepening and broadening integration of ASEAN shall be accompanied by technical and development cooperation in order to address the development divide and accelerate the economic integration of CLMV countries...”

The *Vientiane Action Plan (VAP)* is a 6-year plan to realise the end goal of ASEAN Vision 2020 and Declaration of ASEAN Concord II, and focuses on deepening regional integration as well as to reduce the large disparities in per capita GDP (and other human development dimensions). Measures and strategies to narrow the development gap include the following:

- *Special and differential treatment* to CLMV countries in implementing ASEAN agreements and obligations under AFTA/AFAS/AIA, in recognition of the different capacities of adjustment to the liberalisation process.

First, the CLMV countries have been given a longer time frame for tariff reduction obligations under AFTA. ASEAN-6 completed the first phase of AFTA on 1 January 2003 with tariffs down to 0-5% level except for Malaysian automobile tariffs. Vietnam is scheduled to reach 0-5% level by 2006, Laos and Myanmar by 2008 and Cambodia by 2010. For zero tariffs, CLMV have also an extra five years until 2015. CLMV have also acceded to AFAS and AIA, with delayed or flexible schedules.

Second, the *ASEAN Integrated System of Preferences (AISP)* is a unilateral preferential scheme by ASEAN6 offered to imports from CLMV and implemented in January 2001. CLMV countries have been unable to benefit fully from AFTA because of their own delayed schedule of trade liberalization. AISP is implemented on a voluntary and bilateral basis. As at May 2005, the CLMV countries have received 102 tariff preferences (either zero tariffs or 0-5% tariffs) from Brunei, 440 from Indonesia, 553 from Malaysia, 77 from the Philippines and 990 from Thailand. As Singapore has no import tariffs, it did not implement any AISP. However, the AFTA Council meeting in September 2005 noted with concern the low utilisation rate of AISP and called for the ASEAN-6 to further improve the preferences given to the CLMV both in terms of product coverage and AISP rates, and for CLMV to take advantage of the opportunities provided under the scheme.

- A collective ASEAN enjoys *better negotiating leverage* with major industrial countries. ASEAN can extend its collective weight to CLMV efforts to attract FDI, technology, and development assistance and gain market access. ASEAN sponsors investment road shows, expositions and fairs. It supports CLMV membership of WTO, APEC, and ASEM.
- *Sharing experiences* on how the more advanced ASEAN countries have planned and implemented their development policies, strategies and programmes, so that CLMV countries can draw lessons and best practices to apply to their own development strategies and efforts.
- *Technical and development cooperation* at the ASEAN and bilateral levels to help CLMV members build the necessary capabilities and skills to facilitate and accelerate the process of economic integration and narrow the development gap.<sup>2</sup> Technical assistance covers both the transfer of technical knowhow as well as targeted financial assistance. Provision of technical knowhow could be aimed at facilitating the adoption and implementation of specific policies and include training, workshops, seminars, and secondment of experts --- for example, help

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<sup>2</sup> The EU experience has shown that the less developed members of Spain, Portugal and Ireland, experienced accelerated GDP growth after accession to the EU and receipt of targeted technical and financial assistance from the EU budget. In particular, Ireland leveraged the technical assistance and undertook major domestic regulatory reforms, so that by 2000 it had transformed from a predominantly agricultural economy to a leading world exporter of software and the major headquarters of international companies and MNCs

governments improve fiscal management to offset revenue loss from elimination of import tariffs; improve the efficiency of trade documentation and customs procedures; assistance with mutual recognition of test reports and certifications; assist with intellectual property rights legislation and enforcement. Targeted financial assistance could include building hardware and software capacity in infrastructure, ICT, and human resource development.

- The *Initiative for ASEAN Integration (IAI)* adopted in November 2000 is ASEAN's main instrument for delivering technical and development cooperation to the CLMV sub-region. Capacity building for regional economic integration is intended to help the CLMV countries take part in and benefit from AFTA/AFAS/AIA and other economic integration schemes. The IAI Work Plan for 2002-08 initially focuses on 4 priority areas--- infrastructure, human resource development, ICT, and capacity building for regional economic integration, but this was later extended to include energy, investment climate, tourism, poverty reduction and improvement in the quality of life. In many instances, the measures and projects in the Work Plan are part of region-wide programmes of ASEAN but specially focused on CLMV.<sup>3</sup>

. The ASEAN-6 contributions take various forms, including training, provision of technical experts and supply of equipment, and seeking funding support from ASEAN's dialogue and development partners. Since 1996, the ASEAN-6 have contributed some US\$165 million, comprising 58 projects worth US\$4.59 million, and bilateral contributions of US\$159.4 million to implement 209 projects. Obviously these resources are limited, when compared to the needs of CLMV countries and their total receipts of ODA. ASEAN-6 need to leverage their IAI activities through cooperation with donor countries such as Korea, Japan, India, Norway and Australia and cooperate closely with the ADB's Greater Mekong Subregion (GMS) scheme.

A comprehensive review undertaken of the IAI Work Plan found most of the projects have been judged to be beneficial, with positive feedbacks from all CLMV countries.. However, some shortcomings have been revealed, such as the narrow focus of the Work Plan; weak inter-agency coordination, reporting mechanisms, implementation and follow-through actions; weak ownership of the IAI projects by the CLMV countries; and inadequate coherence of training programmes and duration of training courses. This led to recommendations to expand the scope of the Work Plan; improve the criteria for selection of IAI projects; improve coordination among the countries and agencies involved; and improve CLMV ownership through CLMV's active participation in all stages of the project and CLMV contribution to the project in cash or kind.

## 4. CONCLUSION

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<sup>3</sup> Most of the proposals in infrastructure are segments of the Singapore-Kunming Rail Link, the ASEAN highway network, the ASEAN Power Grid and the Trans-ASEAN Gas Pipeline Network. The ICT component is derived largely from the e-ASEAN programme and the ASEAN e-readiness assessment. The HRD component runs through all the other components of IAI.

ASEAN economic integration and the integration of the CLMV sub-region into ASEAN have proceeded much more slowly than many analysts and observers would like to see. However, ASEAN has come a long way from the days of national autarkic and inward-looking policies and the ASEAN region has improved on their ability to respond to the challenges of technological change, globalisation and the rise of China.

The CLMV sub-region can draw on and contribute to the strengths of ASEAN. The CLMV sub-region has achieved remarkable results in transforming their economies since the early 1980s. They have enjoyed buoyant economic growth, and become increasingly integrated with ASEAN, East Asia and the global economy as witnessed their rising trade and investment flows and participation in the international and regional division of labour. Membership of ASEAN has helped overcome some political obstacles and provide many economic opportunities. Membership of the WTO will no doubt open up more economic opportunities for Cambodia, Laos and Vietnam. However, above all, economic success of the CLMV countries has depended crucially on undertaking the necessary domestic reforms of the legal and regulatory framework, institutions and economic policies. Membership of ASEAN and WTO will help ensure that the CLMV countries continue to reform and restructure their economies and improve their capacity building to remain globally and regionally competitive.

ASEAN will be stronger and more united when the CLMV sub-region has caught up with the more developed ASEAN sub-region. In the mean time, ASEAN should continue and expand capacity-building for the CLMV sub-region. The various ASEAN+1 initiatives in the pipeline (with China, Japan, India, Korea, and CER) contain special and differential treatment, flexibility, and development cooperation provisions that should open up new economic opportunities and capacity-building resources for the CLMV sub-region.

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# Integrating the Mekong Region into ASEAN



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Presentation prepared for the seminar "Accelerating Development in the Mekong Region—the Role of Economic Integration", Siem Reap, Cambodia, June 26–27, 2006. The views expressed in this presentation are those of the author and should not be attributed to the International Monetary Fund, its Executive Board, or its Management.





# Indicators of CLMV Integration into ASEAN...1

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- ASEAN was formed in 1967, AFTA implemented in 1992, AFAS in 1995, AIA in 1998
- Vietnam joined ASEAN in 1995, Laos and Myanmar in 1997, Cambodia in 1995
- Indicators of CLMV integration into ASEAN show a mixed picture, given the inadequate statistics
- Intra-ASEAN trade in goods 2002
  - Cambodia \$690 million, 19.3% share
  - Myanmar \$2.4 billion, 52.8%
  - Are trade statistics reliable?
- Intra-ASEAN investment flows 2001-2003
  - Laos \$14 million, 20.6% share
  - Myanmar \$116.8 million, 22.9% share
  - Vietnam \$542.3 million, 13.7% share



# Indicators of CLMV Integration into ASEAN...2

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- Intra-ASEAN industrial complementation and production networks?
  - Electronics, textiles/garments, automotive?
- Intra-ASEAN trade in services
  - Financial services, e-services, telecomms services, tourism, professional services etc
- Intra-ASEAN people exchange and flows
  - Tourist flows
  - Student and cultural flows
  - Meetings of politicians, government officials, business sector, NGO sector
- Transport & logistics integration



# Factors Impacting CLMV Integration into ASEAN...1

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- CLMV are low income transitional economies
- Lack of economic complementarity between ASEAN6 (except Singapore) and CLMV
- Asian financial crisis reduced capacity of ASEAN6 to provide markets and investments for CLMV
- EU-US markets became much more important for CLV with restoration of normal trade relations and preferential treatment
- Rise of China diverted investors from ASEAN6 to China
- Japan provided much more ODA and technical assistance to CLMV
- Cambodia, Laos and Vietnam preoccupied with WTO accession



# Impact of ASEAN Membership on CLMV...1

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- ASEAN implemented AFTA in 1992, AFAS in 1995 and AIA in 1998. AEC to be realized by 2015 with free trade in goods and services, free flow of skilled labour and freer flow of capital
- Expected economic benefits for CLMV
  - Preferential market access under AFTA and AFAS
  - Benefits from efficient resource allocation, economies of scale, dynamic effects from increased competition
  - Better access to FDI and technology transfer
  - Learning from best practices
  - Pressure to sustain domestic economic reforms



# Impact of ASEAN Membership on CLMV...2

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- **Costs and concerns of CLMV**
  - **Loss of import tariff revenue**
  - **Concern over non-competitive domestic industries and services**
  - **Concern over “strategic” industries and services and SOE sector**
  - **Concern over investment and trade diversions**
  - **Concern over structural unemployment and lack of social safety nets**



# Narrowing the Development Gap in ASEAN ...1

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- **The development gap**
  - Per capita incomes in CLMV much lower than most of ASEAN6; same for other development indicators
  - Some catch up in recent years as CLMV have been growing faster than most ASEAN countries, particularly Indonesia and Philippines
  - But absolute gap between CLMV and advanced ASEAN countries in per capita income will remain large
- **Need to narrow development gap**
  - For ASEAN economic cohesion and community building
  - For CLMV to exploit the economic opportunities



# Narrowing the Development Gap in ASEAN ...2

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- **ASEAN efforts to narrow development gap**
  - Limited efforts in immediate post-Asian financial crisis years
  - Hanoi Declaration of 2001
  - Declaration of ASEAN Concord II in 2003
  - Vientiane Action Plan
- **Special and differential treatment in recognition of different capacities**
  - Longer time frame to fulfill obligations under AFTA, AFAS and AIA
  - ASEAN Integrated System of Preferences (AISP)



# Narrowing the Development Gap in ASEAN ...3

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- Leveraging on ASEAN in negotiations with non-ASEAN economies and improved market access and access to FDI, technology transfer and ODA
- Learning from the development experiences and best practices of ASEAN6
- Technical and development cooperation at ASEAN level and bilateral level from ASEAN6
  - Transfer of technical and managerial knowhow and targeted financial assistance
  - Initiative for ASEAN Integration (IAI) adopted in November 2001





## Narrowing the Development Gap in ASEAN ...4

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- International and regional help (through ASEAN) can help CLMV to narrow the development gap by providing additional resources, economic opportunities and incentives.
- Crucial domestic role of furthering and sustaining economic reforms to improve economic competitiveness and efficiency and ensure growth with equity
- Among the CLMV countries, Vietnam has the brightest economic prospects and could overtake Indonesia and the Philippines .