

CLMV and East Asian Integration*

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This paper sets out some thoughts concerning the development of CLMV countries, Cambodia, Lao PDR, Myanmar and Vietnam (but mainly focusing on CLV) in the context of the broader process of East Asian Integration. As I am from Thailand and not from a CLMV country, this is very much an outsider's perspective. The paper just sets out some personal views for further discussions concerning how CLMV fits into the broader regional integration processes in East Asia (now possibly also extending to South Asia and Australasia). The paper starts by briefly setting out the background of East Asian Integration. The paper then looks at East Asian Integration from the perspective of ASEAN as a whole. Finally, the paper looks at CLMV countries in the context of East Asian integration.

EAST ASIAN INTEGRATION

In the last decade, East Asia has actively embarked on a path toward greater regional integration. The major event that started off the process was the financial crisis that started in Thailand in 1997 and expanded to affect almost all countries in the region. The contagion resulting from the crisis showed that East Asian economies were closely linked to each other and each country could not afford to ignore what was happening elsewhere within the region.

At the time of the crisis, East Asia was in fact a region of reasonable financial strength. The East Asian region as a whole was a saving surplus region prior to the crisis,¹ yet the saving deficit countries in the region that became insolvent during the crisis and had to resort to IMF assistances (Thailand, Indonesia and South Korea) had to rely mostly on short-term foreign borrowings to finance their saving deficits. The saving surplus of the region was invested mostly in US dollar denominated assets from outside the region and the deficit countries had to rely on foreign bank borrowings which were mostly short-term in nature. The short-term

foreign debts of the three East Asian countries that became insolvent increased to become larger than the amount of the official foreign reserves in all three countries. This meant that if the debts were not rolled over, each country would not have enough foreign currencies to repay the debts. This was a fundamental reason for the financial crisis in all the three countries. It was ironic that while the East Asian region as a whole was financially strong prior to the crisis, there was a lack of cooperation and self-help mechanisms that could have utilized the region's financial strengths to avoid the crisis.

Given the painful experiences of the crisis and the belief that if there were more financial cooperation mechanisms in the region prior to the crisis, then the crisis could possibly have been avoided, countries in the region moved quickly to develop various post-crisis financial cooperation initiatives. Most significant was the formation of the ASEAN+3 group (ASEAN plus China, Japan and South Korea). Such a grouping was difficult to envisage prior to the crisis due to political frictions among some of the key countries. The formation of the ASEAN+3 group and subsequent developments of a number of concrete financial cooperation initiatives were direct outcomes of the crisis. Modes of financial cooperation that have been pursued ranged from surveillance and early warning mechanisms, the setting up of a regional financing facility made up of foreign reserves swap arrangements, the so-called Chiang Mai Initiative (CMI), and initiatives to develop the Asian Bond market; the launching of the Asian Bond Fund 1 and 2 and activities under the Asian Bond Markets Initiative (ABMI).

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 region and globally. To support its economic development and also enhance its role in the region, China initiated the ASEAN-China FTA which was very quickly agreed to by the leaders of ASEAN, and the

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Framework Agreement of the FTA was signed in November 2002. Subsequently, this was followed by a series of FTA initiatives within the region, with ASEAN (and individual countries within ASEAN) playing an important role as the hub of many of these FTA's.

The framework agreements for an ASEAN-Japan FTA (called "comprehensive economic partnership") and an ASEAN-India FTA were signed in October 2003. That for an ASEAN-South Korea FTA was signed in December 2005, and the intention to negotiate a FTA between ASEAN and Australia/New Zealand was announced in November 2004. The United States is also in the picture with an Enterprise for ASEAN Initiative (EAI) that opened the window for possible bilateral FTA's between the United States and members of ASEAN along the lines of the Singapore-US FTA that was concluded in May 2003. In addition, there are numerous FTA's concluded or being pursued by individual ASEAN countries and various partners, for example Thailand has agreements with Australia, New Zealand, Bahrain, China and India, one pending with Japan, and is in negotiation with the USA, Peru and the European Free Trade Association (EFTA), and is likely to pursue FTA's with many other countries in the future.

It seems that as more FTA's within the region are concluded or are being negotiated, there is a built-in momentum leading to ever more FTA's. This is because countries do not want to be excluded from the proliferation of FTA's, as being left out could mean being discriminated against down the road. All these FTA's result in the so-called "spaghetti bowl effect," and critics have pointed to the partial nature of most of these FTA's with many exclusions and exceptions and possible inconsistencies among themselves on various issues, such as on rules of origin, so that they may not in fact be effective building blocks for efficient regional integration of East Asia as a whole² (or extended East Asia including South Asia and Australasia). However, while these FTA's may have many inconsistencies among themselves, if each remains WTO consistent and pushes out the envelop of trade liberalization, then they could nevertheless lead the region eventually toward a comprehensive economic cooperation framework for East Asia as a whole.

The various on-going financial, trade and economic cooperation initiatives within the region indicate the tremendous progress that has been made on intra-region cooperation compared to what was happening a decade or so ago. This has led to the holding of the first ever East Asia Summit (EAS) in Kuala Lumpur, Malaysia in December 2005. This historic summit was attended by leaders from the 10 member states of ASEAN, China, Japan, South Korea, India, Australia and New Zealand. In their declaration, the leaders vowed to promote cooperation in political and security issues, development, financial stability, energy security, economic integration and growth, poverty eradication

and narrowing the development gap in East Asia, as well as to promote deeper cultural understanding and mutual trust. This meeting was clearly a symbolically significant event. It should be remembered that just over a decade ago, the idea of the East Asian Economic Caucus (comprising economies close to the ASEAN+3 group) could not get off the ground when Dr. Mahathir Mohamad proposed it back in 1991, so East Asia has come a long way since then. While the EAS did not achieve any concrete substance, and countries involved in the EAS still have a very long way to go if they are to effectively integrate economically, especially if an end point similar to the European Community is envisaged, new initiatives in this direction are continually being developed. Japan has recently proposed the launching in 2008 of negotiations to establish a huge regional FTA among countries that attended the EAS, and initiatives in the area of deeper financial and monetary cooperation continue to be explored and developed within the region. Even though East Asia does not have a comparable history as Europe or the necessary push factors that can convince countries in the region that reducing their sovereignty for the sake of economic and/or political integration will be a good thing, these kinds of initiatives can push countries in the region to focus more and more attention on what can be done to remove various barriers that hamper effective regional integration and they should lead to gradual movements toward a more fully integrated region in the longer term.

ASEAN AND EAST ASIAN INTEGRATION

The trend of greater East Asian integration offers many opportunities as well as poses many challenges for countries in ASEAN. The on-going financial cooperation initiatives can provide greater protection to ASEAN from future crises similar to the previous crisis. The larger market resulting from greater trade integration should create greater demand for ASEAN products, whether goods or services including tourism. It will also offer greater investment opportunities for ASEAN businesses (particularly the larger business groups). However, there are also concerns that the manufacturing production bases that have been built up in ASEAN over the past several decades could be adversely affected, particularly by competition from lower cost and efficient manufacturing production bases in China (and may be India in the future). ASEAN has already lost market share to China in third countries' markets for many products. While this has been compensated to some extent by greater export from ASEAN to China, the prospects for ASEAN manufacturing are still very uncertain. How this may develop in the future is not well understood at present because a significant part of the manufacturing production bases in ASEAN belongs to multinational enterprises (MNE) and how these

enterprises will strategically position their production bases in the region in the future under the environment of freer trade within the region is still not clear.

One possible scenario is that MNE's production bases in ASEAN will not expand much in the future, with most of the expansion happening in China. The much greater size of foreign direct investment (FDI) in China compared to that in ASEAN in recent years shows that this has already happened to some extent. On the other hand, MNE's cannot afford to put all their eggs in China, given uncertainties about how the gap between economic and political developments in China will eventually be resolved and also the remaining tensions between China and Japan. So ASEAN should still be able to attract FDI at a certain level. However, there is no guarantee that this will happen automatically and will depend on ASEAN's own ability to make the region competitive enough to remain a significant manufacturing production base for MNE's.

ASEAN was highly regarded as a competitive region a few years prior to the crisis. The crisis and the rapid emergence of China changed this picture significantly. At this point it is very important for ASEAN to revitalize its competitiveness in order to meet future challenges and exploit opportunities arising from greater economic integration in the region and also globally through the WTO process. To become more competitive, ASEAN countries will need to carry out domestic "upgrading" policies in many areas, particularly in regulatory and physical infrastructures, technological capability and skills formation. ASEAN also needs to learn from the example of China that "size does matter." To better exploit the benefits of size, ASEAN will need to integrate a lot more and a lot more quickly in order to reduce the costs of doing business in ASEAN, to make the region more competitive and more attractive for foreign investment. ASEAN needs to make itself an efficient production base "as a region," rather than remains as a grouping of individual country production bases. This will allow MNE's in ASEAN to move away from country-base production strategies to a truly ASEAN regional production strategy, allowing full exploitation of economies of scale and of scope. Unless ASEAN pushes ahead quickly with much deeper economic integration to achieve this, there is a real danger that each of the ASEAN economies will become marginalized within a large Asian region dominated in size by China and India, and dominated technologically by Japan and South Korea (and also Australia and New Zealand).

The issue of deeper integration of ASEAN into some form of an ASEAN Economic Community (AEC) has been under discussion within ASEAN for a number of years. ASEAN leaders have set 2020 as the target date for reaching the AEC. Some countries, such as Singapore and Thailand, have tried to push for an earlier target date because 2020 is very far away, and ASEAN may have already lost a lot of competitiveness by that

time. However, many ASEAN countries, both from the older and newer member countries, still feel that they are not ready for deeper integration, and it has taken a number of years before ASEAN can agree to move forward the target date for the AEC. Finally, at the Thirty-Eight ASEAN Economic Ministers' (AEM) Meeting in Kuala Lumpur in August 2006, the AEM agreed to recommend to the ASEAN leaders to move forward the date for the formation of the AEC to 2015 from 2020.

At the same time, as a sort of compromise, ASEAN has also pursued a sectoral integration approach where 11 priority sectors have been targeted for fast-tracked ASEAN integration. These are agro-based products, fisheries, wood-based products, rubber-based products, textiles and apparels, electronics, automotives, air travel, tourism, healthcare and e-ASEAN. The ASEAN Framework Agreement for the Integration of Priority Sectors was endorsed by ASEAN leaders in November 2004, and roadmaps for the integration of these sectors have been drawn up covering a broad range of issues; such as, tariff elimination, non-tariff measures (NTMs), rules of origin, customs procedures, standards and conformance, logistics services, investments, trade and investment promotion, intellectual property rights, movement of business persons, skilled labor and professionals, human resource development and research and development. It is difficult to judge whether these sectoral integration roadmaps will be effective in significantly improving ASEAN competitiveness in these sectors. In many areas, detailed implementation plans remain to be worked out. More worrying is that countries still put many products into sensitive lists excluding them from the Framework Agreement, so it is not clear how serious are the intentions for real integration among ASEAN countries.

It is ironic that while many ASEAN countries have been reluctant to move more quickly toward an AEC, they have actually pursued many FTA's with various partners that will bring about a great deal of competition for their economies. It seems that most ASEAN countries tend to focus on the competition among themselves from a country perspective when thinking about ASEAN integration. The weaker countries fear that with ASEAN integration they will be unable to attract FDI and build up the production bases within their countries and instead products produced in the stronger countries will flood their markets. Yet in the pursuit of FTA's with highly competitive trading partners, such as China, the worry that FDI will be diverted to China and products from China will flood ASEAN markets does not appear to be as prominent. This is a puzzle, but possibly the attraction of easier access to the huge Chinese market may have diverted attention from the risks of shifts in production bases to China. Nevertheless, given that many ASEAN countries are concerned with greater competition arising from deeper economic integration within ASEAN, it is inevitably that

as East Asian integration proceeds, many ASEAN countries will become more concerned with greater competition arising from the process so that many obstacles are likely to remain for a truly effective economic integration in East Asia.

Many ASEAN countries would like to see appropriate sequencing along the path of East Asian integration. For example, some unease about the name "East Asia Summit" have been expressed from within ASEAN. It was felt that calling the meeting an East Asia Summit will downgrade the importance of ASEAN, and ASEAN countries will simply become a marginalized part of the Asia region. It would be better for ASEAN if ASEAN can integrate to become an AEC first and revitalize its competitiveness, so that it can participate in an eventual "Asian Economic Community" or even an "Asian Community" similar to the "European Community" on equal terms with other larger and more technologically advanced members in Asia. The "Kuala Lumpur Declaration on the East Asia Summit" on December 14, 2005, clearly tried to take account of this unease by some ASEAN countries. It declared that "participation in the EAS will be based on the criteria for participation established by ASEAN" and that "the EAS will be hosted and chaired by an ASEAN Member Country that assumes the ASEAN Chairmanship and held back-to-back with the annual ASEAN Summit." Thus, the declaration assured that ASEAN will remain at the center of this grouping, at least for the time being. However, ASEAN's eventual role in an integrated East Asia is still somewhat of an open question.

CLMV AND EAST ASIAN INTEGRATION

While the opportunities and challenges for ASEAN arising from East Asian integration are

considerable, those for CLMV countries are of much greater magnitudes. As the least developed countries in the ASEAN+3 group and also countries still undergoing fundamental market oriented reforms, CLMV countries have to deal simultaneously with integration issues at three levels:

- Integration into the global economic system;
- Integration into ASEAN; and
- Integration into East Asia.

The pace of integration into the global and regional economic system varies somewhat between the various CLMV countries as shown in Table 1.

Myanmar has hardly opened up to the outside world at all. Cambodia and Vietnam have rapidly increased their participation in world trade, and trade openness ratios have increased from about 65-75 percent to about 140 percent over the past decade. Lao PDR is in between with an openness ration of about 70 percent, but this ratio has been fairly stable over the past decade.

Table 2 gives details on the main trading partners of the CLV countries. The data exhibit some interesting patterns. First, in terms of exports from the CLV countries, the main thrust has been on exports to markets outside East Asia. For all three countries, the shares of exports going to markets outside East Asia has increased significantly between 1998 and 2004; Cambodia's share of exports to non-East Asian markets increased from 49.3 percent in 1998 to 87.5 percent in 2004, and during the same period Lao PDR's share increased from 53.1 percent to 63.4 percent, and Vietnam's share increased from 51.4 percent to 62.4 percent. This export pattern shows that the CLV countries have successfully entered into the global export market and shows their increasing integration into the global economic system.

Table 1 Trade Openness

Ratio of Export of Goods and Services to GDP (%)	1994	1999	2004
Cambodia	25.84	40.45	64.72
Lao PDR	25.01	33.53	28.90
Myanmar	1.50	0.42	0.35*
Vietnam	34.01	49.97	66.38
Ratio of Import of Goods and Services to GDP (%)	1994	1999	2004
Cambodia	38.75	53.51	75.80
Lao PDR	39.83	41.36	41.91
Myanmar	1.93	0.71	0.37*
Vietnam	43.46	52.82	73.61
Trade Openness (%) (sum of export and import ratios)	1994	1999	2004
Cambodia	64.58	93.95	140.52
Lao PDR	64.84	74.88	70.81
Myanmar	3.43	1.13	0.72*
Vietnam	77.47	102.79	139.99

* Data for 2002.

Source: World Bank, World Development Indicators (from World Bank website).

Table 2: Trade Destinations and Average Growth

Cambodia	Exports Shares (%)		Avg. Growth (%)	Imports Shares (%)		Avg. Growth (%)
	1998	2004	1998-2004	1998	2004	1998-2004
Total	100.0	100.0	18.5	100.0	100.0	21.0
East Asia	50.7	12.5	-6.1	60.7	83.4	27.6
Japan	0.8	3.5	50.0	6.3	2.5	3.7
Korea	0.1	0.2	48.1	8.5	3.9	6.4
China+HK+MC	7.4	1.3	-10.8	20.0	27.7	27.8
Thailand	8.2	1.0	-17.1	14.9	22.5	29.5
CLMV	18.8	4.4	-6.9	8.0	10.9	27.3
Other ASEAN	15.3	2.1	-15.1	2.9	15.8	60.2
US	31.4	55.9	30.5	3.5	1.8	8.8
Rest of the World	17.9	31.6	30.3	35.9	14.8	4.3
Laos	Exports Shares (%)		Avg. Growth (%)	Imports Shares (%)		Avg. Growth (%)
	1998	2004	1998-2004	1998	2004	1998-2004
Total	100.0	100.0	6.5	100.0	100.0	8.6
East Asia	46.9	36.6	2.1	88.9	85.6	7.9
Japan	4.8	1.3	-13.8	3.3	1.5	-5.0
Korea	0.0	0.2	230.8	0.8	0.9	11.0
China+HK+MC	2.0	2.1	7.8	4.5	11.1	26.3
Thailand	7.8	19.3	23.9	63.8	60.5	7.6
CLMV	32.2	13.4	-8.0	12.5	7.2	-0.9
Other ASEAN	0.2	0.1	1.2	4.0	4.4	10.4
US	5.4	0.6	-25.7	0.6	0.6	9.4
Rest of the World	47.7	62.8	11.5	10.5	13.7	13.5
Vietnam	Exports Shares (%)		Avg. Growth (%)	Imports Shares (%)		Avg. Growth (%)
	1998	2004	1998-2004	1998	2004	1998-2004
Total	100.0	100.0	18.5	100.0	100.0	19.7
East Asia	48.6	37.6	13.6	65.1	64.5	19.5
Japan	16.3	13.6	15.0	13.1	10.5	15.4
Korea	2.5	2.4	17.8	12.6	10.8	16.7
China+HK+MC	8.1	10.6	23.9	9.5	17.8	32.9
Thailand	3.2	1.5	5.2	6.0	6.2	20.5
CLMV	1.6	1.7	19.4	1.5	0.7	4.6
Other ASEAN	16.9	7.8	4.1	22.4	18.5	15.9
US	5.0	20.2	49.4	2.9	3.9	25.6
Rest of the World	46.4	42.2	16.6	32.0	31.6	19.4
CLV	Exports Shares (%)		Avg. Growth (%)	Imports Shares (%)		Avg. Growth (%)
	1998	2004	1998-2004	1998	2004	1998-2004
Total	100.0	100.0	18.2	100.0	100.0	19.4
East Asia	48.7	35.4	12.0	65.9	66.9	19.7
Japan	14.5	12.5	15.2	12.0	9.5	14.8
Korea	2.2	2.1	18.0	11.6	9.9	16.1
China+HK+MC	7.9	9.6	22.2	10.1	18.5	32.0
Thailand	3.8	1.8	4.7	9.6	9.2	18.6
CLMV	4.2	2.2	5.7	2.6	1.8	12.2
Other ASEAN	16.2	7.1	3.1	19.8	17.9	17.3
US	7.4	23.0	42.9	2.8	3.6	24.2
Rest of the World	43.9	41.6	17.1	31.3	29.6	18.2

Note: HK = Hong Kong, MC = Macao.

Source: IMF, Directions of Trade Statistics, 2005 Yearbook.

Import patterns are however very different. The share of imports from outside East Asia for CLV has been fairly stable between 1998 and 2004, changing from 34.1 percent in 1998 to 33.2 percent in 2004. This hides some differences among the CLV countries. The shares for Lao PDR and Vietnam have been fairly stable, but Cambodia's import share from outside East Asia has declined substantially between 1998-2004, from 39.4 percent to only 16.6 percent.

Within East Asia, Cambodia's import shares from China,³ Thailand, other CLMV and ASEAN countries all increased significantly between 1998-2004, showing Cambodia's integration into ASEAN and with China. Lao PDR's imports come mainly from Thailand (more than 60%). In recent years, China's share in Lao PDR's imports has increased significantly, from 4.5 percent to 11.1 percent between 1998-2004. In the case of Vietnam, China's share of imports also increased significantly between 1998-2004, from 9.5 percent to 17.8 percent. Thailand's share also increased just slightly from 6.0 percent to 6.2 percent, while the shares from Japan, Korea and the rest of ASEAN all declined.

These trade patterns suggest that the CLV countries have been able to link to the supply chain within the region, particularly to China, Thailand and some other ASEAN countries, for eventual export outside East Asia (particularly to the US and Europe). In spite of a great deal of competition from both within the region and from elsewhere, the CLV countries have been able to take advantage of the various trade privileges available to newer developing countries and the still relatively low labor costs. One can also see a pattern of greater integration into the regional economic system, particularly to neighboring countries such as China and Thailand.

To further integrate into the global and regional economic system and fully benefit from these integrations, the CLV countries need to continue with various domestic market oriented regulatory reform measures to increase efficiency, develop the required human resources and physical infrastructures, while at the same time focus on social and environmental protection and development policies to ensure sustainable development.⁴

Successful development of the CLV (and M) countries is not simply in the interest of the CLV countries themselves, but is actually a critical factor for the successful integration of the region, whether one is talking about ASEAN integration or East Asian integration. An integrated market oriented region, which is the direction ASEAN and East Asia are moving toward, should not exhibit large development disparities among members within the region. If disparities become too large, negative side effects can show up in many areas. For example, development disparities between Thailand and neighboring countries with long land borders have already led to a big problem of undocumented labor migration. It is estimated that there are about 1.5 million undocumented labor migrants in Thailand, with most

coming from Myanmar. In addition, development disparities also bring about other cross border problems, such as illicit activities such as smuggling and human trafficking.

Currently the development gaps in East Asia are still very large. In 2004, the average per capita GDP for CLV was about US\$516 compared to ASEAN5 of about US\$1,860 and ASEAN5+3 (plus China, Japan and South Korea) of about US\$4,272. To close these development gaps, the CLV countries need to be growing much faster than the other countries. Within ASEAN, recent data suggest that growth rates of real per capita GDP in the CLV countries have been edging up above the older ASEAN member countries (Table 3). The data for the 1995-1999 period is somewhat misleading as the older ASEAN member countries were more effected by the crisis than the CLV countries. However, even in the latter period (2000-2004), Cambodia and Vietnam performed better than the ASEAN5 countries and Lao PDR was only out-performed by Thailand among the ASEAN5 countries.

Table 3 Average Real Per Capita GDP Growth and Per Capita GDP

	Avg. Growth (%) 1995-1999	Avg. Growth (%) 2000-2004	Per Capita GDP 2004 (US\$)
China	8.12	8.52	1,490
Japan	0.97	1.08	36,182
Korea, Rep.	3.86	4.84	14,136
Indonesia	0.31	3.29	1,184
Malaysia	2.68	3.22	4,753
Philippines	1.62	2.46	1,036
Singapore	3.16	2.88	25,191
Thailand	0.48	4.18	2,539
Cambodia	4.65	4.77	354
Lao PDR	4.00	3.58	423
Vietnam	5.99	6.02	550

Source: World Bank, World Development Indicators (from World Bank website).

While the CLV countries are performing quite well recently and generally better than the ASEAN5 countries, they still cannot match China's performance. Thus, the average development gap between China and CLV is increasing rapidly and this could possibly create additional problems for East Asian integration, particularly the integration of China and ASEAN. Of course, China is a very large country and there are large development gaps within China so that the gaps between CLV and Central Southern provinces of China close to CLV are not as large as the average gap between China and CLV.

Even though CLV countries are performing quite well in recent years, it will still take a long time before the development gaps between CLV and other parts of

ASEAN and East Asia are closed significantly. And because closing the development gaps is considered to be very important for successful economic integration in the region, there is a common interest for countries in East Asia to provide development assistances to CLMV countries, whether financial or technical. As ASEAN has become the hub for FTA agreements in the region, so CLMV will be the “development hub” for East Asia in the coming decades in order to accelerate CLMV development. Therefore the CLMV countries should be able to benefit substantially from initiatives at the level of ASEAN or East Asia or at the sub-regional level that target their accelerated development. Various initiatives such as the Initiative for ASEAN Integration (IAI), Greater Mekong Sub-Region (GMS), and Ayeyawady-Chao Phraya-Mekong Economic Cooperation Strategy (ACMECS) can provide financial and other technical resources to assist CLMV countries. The plus three countries are also contributing resources to some of these projects as well as providing bilateral assistances to the CLMV countries. These additional benefits to the CLMV countries could be seen as by-products of the economic integration process in East Asia. These development assistances are quite important to CLV countries as they still depend on a significant amount of foreign aid (Table 4).

Table 4 Official Aid as Percent of GDP

	1994	1999	2004
Cambodia	11.7	7.9	9.8
Lao PDR	14.0	20.3	11.0
Vietnam	5.6	5.0	4.1

Source: World Bank, World Development Indicators (from World Bank website)

Looking ahead, CLV countries will presumably continue with the three prong levels of integration; at the global level, at the ASEAN level and at the East Asian level. Many of the continual reforms that CLV are carrying out will benefit CLV integration at all levels. For example, market oriented reforms to increase competitiveness will yield benefits at all three levels. Other policies and projects address more specific regional development targets. In the context of East Asian integration, CLV can probably benefit most from a sub-regional integration approach based on geographical proximity. As was already seen in the direction of trade data, the linkages with China are increasing rapidly. At the same time, the linkages to Thailand continue to be very important (particularly for Cambodia and Lao PDR). Therefore, strengthening the economic linkages among CLMV, Thailand and Southern China (the GMS sub-region) should be a major priority for the medium term. It can contribute to China’s goal to more rapidly develop its hinterland in order to reduce the development gaps with its coastal provinces. It will create

a synergy between the economies of Thailand, Vietnam and Southern China and benefit Lao PDR and Cambodia as crucial economic links between Thailand, China and Vietnam.⁵ On this, many transport infrastructure projects have already been proposed (the various corridors) and some have already been implemented. In addition, a number of related agreements already exist, such as the GMS Cross-border Transport Agreement and the ASEAN Framework Agreement on Multimodal Transport. Over the next five years or so, an intensified effort to develop an integrated network of efficient transport linkages in the GMS sub-region should be pursued. This should be the backbone for the dynamic economic development of the GMS area for decades to come.

Finally, turning back to the financial side, which was the impetus for East Asian regional cooperation after the crisis, so far CLV have not been able to participate fully in the regional financial cooperation initiatives. This is not surprising as the financial systems within CLV are still relatively undeveloped as can be seen from the low ratios of domestic bank credit to GDP in Table 5.

Table 5 Domestic Credit Provided by Banking Sector (% of GDP)

	1993	1998	2002
Cambodia	5.1	7.2	5.9
Lao PDR	7.9	10.1*	12.3
Vietnam	11.4	11.5	44.8

* Data for 1999

Source: World Bank, World Development Indicators (from World Bank website)

Nevertheless, CLV can still benefit from various on-going regional financial cooperation initiatives. First and foremost, CLV can learn from the mistakes that were made by various countries prior to the crisis, particularly on macroeconomic regimes and inappropriate sequencing of financial liberalization, and make sure that their own financial development paths avoid the mistakes that were made. CLV should also be drawn in to participate more in financial cooperation activities. This is happening to some extent, such as participation in technical programs or seminars related to bond market developments and other financial areas. However, there are areas where CLV can participate directly in some of the main cooperation initiatives, such as the CMI.

On CMI, given limited foreign reserves of the CLV countries, they should stand to benefit even more from CMI than the other ASEAN countries who have now built up large reserves as they recovered from the crisis. A possibility is to expand the bilateral swap arrangements of the plus three countries to the CLV countries (or a subset). Of course, the swap should not be a one for one swap given limited reserves of the CLV countries. Special and differential treatments (SDT)

should be applied just as in the area of trade integration. It could be a one for ten swap (say) or even a one-way allocation of a limited amount by the plus three countries. The main idea is to bring the CLV countries into the process and as the CMI evolves in the future (for example into a multilateral process with strong surveillance) then the CLV would be involved in the evolution process from the beginning.

ENDNOTES

- ¹ The surplus saving of the East Asian region before the crisis was more than US\$ 100 billion annually. This became even larger after the crisis.
- ² See for example, Razeen Sally, "Free Trade Agreements and the Prospects for Regional Integration in

East Asia," *Asian Economic Policy Review*, Vol. 1, No. 2, December 2006, pp. 306-321.

- ³ Including Hong Kong and Macao.
- ⁴ For discussions of some important reform and development areas see for example Leung Suiwah, Vo Tri Thanh, Kem Reat Viseth, *Integration and Transition—Vietnam, Cambodia and Lao PDR*, Working Papers 05-1, Asia Pacific School of Economics and Government, The Australian National University, 2005.
- ⁵ Countries such as Japan and Korea and other ASEAN countries will of course have very important roles both in the implementation of various development projects and as investors in the sub-region.

