ASIAN DEVELOPMENT BANK

THE MEKONG REGION:
AN ECONOMIC OVERVIEW

March 2004

ABBREVIATIONS

AEC	—	ASEAN Economic Community
AISP	—	ASEAN Integration System of Preferences
AFTA	—	ASEAN Free Trade Area
ASEAN	—	Association of Southeast Asian Nations
BOP	—	balance of payments
BoT	—	Bank of Thailand
BTA	—	Bilateral Trade Agreement
CEPT	—	Common Effective Preferential Tariff
CLMV	—	Cambodia, Lao PDR, Myanmar, and Viet Nam
CLV	—	Cambodia, Lao PDR, and Viet Nam
CPRGS	—	Comprehensive Poverty Reduction and Growth Strategy (Viet Nam)
DSA	—	Debt Sustainability Analysis
DTI	—	Development Triangle Initiative
ECS	—	Economic Cooperation Strategy
EHP	—	Early Harvest Programme
FDI	—	foreign direct investment
FTA	—	Free Trade Area
FY	—	fiscal year
GDP	—	gross domestic product
GEL	—	General Exceptions List
GMS	—	Greater Mekong Subregion
HDI	—	human development index
HIPC	—	Highly Indebted Poor Country
IMF	—	International Monetary Fund
IL	—	Inclusion List
LECS	—	Lao Expenditure and Consumption Survey
MFA	—	Multi-Fiber Agreement
MFIs	—	multilateral financial institutions
MFN	—	Most Favored Nation
MREO	—	Mekong Region Economic Overview
NESDB	—	National Economic and Social Development Board
NPV	—	net present value
NT	—	National Treatment
NTR	—	Normal Trade Relations
RCSP	—	Regional Cooperation Strategy and Program
SARS	—	Severe Acute Respiratory Syndrome
SL	—	Sensitive List
TEL	—	Temporary Exclusion List
UNDP	—	United Nations Development Program
WTO	—	World Trade Organization

NOTE

In this report, "$" refers to US dollars.

CONTENTS

EXECUTIVE SUMMARY

The inaugural issue of *The Mekong Region: An Economic Overview* (MREO) gives context and background to complement and support the Greater Mekong Subregion (GMS) Regional Cooperation Strategy and Program (RCSP) of the Asian Development Bank (ADB).

The MREO analyzes, in detail, topics covered in Chapter II of the RCSP, particularly on external debt. The MREO also analyzes other key economic issues, including how the modalities of economic cooperation—subregionalism, regionalism, and multilateralism—can help overcome the economic challenges that GMS economies face, and take full advantage of new opportunities.

Particular attention is paid to delineating complementarities among those different modalities of economic cooperation.

For instance, the MREO looks at how subregionalism can promote regionalism or even multilateralism, and how regionalism can be employed toward globalization. In other words, we examine how subregionalism and regionalism can act as building, rather than stumbling, blocks toward free and open trade and investment in the Mekong region.

The GMS economies comprise five countries and one province: Cambodia, Lao People's Democratic Republic (Lao PDR), Myanmar, Thailand, Viet Nam, and Yunnan Province of the People's Republic of China (PRC). Its combined land area is 2.34 million square kilometers (km^2), Its population was 257.5 million in 2002, with a population density of about 110 people/km^2 . The average per capita gross domestic product (GDP) was $3,288 in 2002.

The GMS is one of the world's fastest-growing subregions. Growth was robust in 2002 in all of GMS, ranging from 5.5% in Cambodia to 7.0% in Viet Nam. Available data suggest that growth has strengthened in most cases in 2003 despite the Severe Acute Respiratory Syndrome (SARS) epidemic and the uncertainties induced by the war in Iraq. All of GMS except Cambodia is expected to have grown by about 6% or higher in 2003, with Viet Nam again topping the list at 7.1%. This economic growth is remarkable, by any standard.

The CMLV countries (Cambodia, Myanmar, Lao PDR, and Viet Nam) face a set of common problems because their economies are in transition from centrally planned to market economies. These countries are undergoing multiple transitions, which present both challenges and opportunities. The future of GMS will largely depend on how successfully its member economies manage these transitions.

The first important transition is in the changing roles played by the state, and in markets. Acceptance is growing that markets and the private sector can do many things better than government. Consequently, the private sector's contribution to total economic activity has been growing faster than the state's contribution in most GMS economies.

A second important transition is the increasing diversification of most GMS market economies. Subsistence agriculture is giving way to commercialized agriculture, and the share of agriculture in total income is beginning to fall with the expansion of emerging manufacturing activities, including agro-processing. This diversification pattern is both a cause and a consequence of rising incomes and greater prosperity.

Social changes will also affect GMS economic conditions. Populations are still young, but the proportion of the working-age populations will rise over the next two decades. Low-productive, subsistence agriculture will not be able to fully absorb new entrants to the labor force. Economic diversification is already taking place, but much is a natural process associated with economic growth. Unless there are specific interventions to complement and speed the pace of this natural diversification, unemployment will probably rise significantly in the future.

Finally, and related to the development of markets, the GMS economies are becoming more "open" economically. The ratio of total trade to GDP in Cambodia, Thailand, and Viet Nam is already higher than 100%. Informal cross-border trade has always been important, but there is now a growing resumption of integration in formal trade and investment flows in the subregion.

Many of these transitions are direct or indirect results of reform programs—but overcoming their challenges and fully realizing their opportunities is in no sense preordained. Much will depend on choices that are made in going forward, and how policy makers address individual and collective challenges. The different modalities of economic cooperation of GMS economies will play an important role in overcoming these challenges, and in taking the region forward.

Economic cooperation and integration are taking place at three levels: subregional, regional, and multilateral. We define the subregion to comprise GMS members. The region, on the other hand, is defined as including all 10 countries that are currently members of Association of Southeast Asian Nations (ASEAN). Multilateralism or globalization is defined as a residual, and refers to engagement with countries outside the subregion or region.

At the subregional level, the GMS program is helping the Mekong economies forge the links and trust that are vital to exploit complementarities, to address shared problems, and to generate economies of scale. Through priority initiatives such as the East-West, North-South, and Southern Economic Corridors, ADB plays a catalytic role in promoting trade and spreading development benefits throughout the GMS. The GMS program also supports a range of measures to facilitate trade and investment, as well as a GMS single visa scheme, which are designed to promote integration.

The GMS program is a classic case of market integration, as opposed to institutional integration. Institutional integration is characterized by legal agreements and institutional arrangements that promote trade among members of the agreement on a preferential basis. Market integration, on the other hand, relies on nonofficial institutions that provide regional public goods that reduce transaction costs associated with the international movement of goods, services, and other production factors.

Market integration is causing subregionalism to drive regionalism and multilateralism through positive spillover effects. The benefits that accrue from improved infrastructure or from measures to facilitate trade and investment are not confined to the subregion. Emerging transport networks and economic corridors in the subregion are transforming the economic geography of the region as a whole. Subregional measures to facilitate trade and investment complement measures being pursued by the ASEAN Free Trade Area (AFTA), which are consistent with the World Trade Organization (WTO). Thus, countries outside the subregion will also have access, directly or indirectly, to these initiatives and measures, so they will generally contribute to increased trade and investment.

At the regional level, ASEAN and AFTA are driving trade liberalization and the opening of markets. Tariffs have already fallen sharply for a wide range of commodities as a result of meeting AFTA commitments. The CLMV countries are getting closer to their target dates when 0–5% tariffs will apply to most of the intra-ASEAN trade. Also, the ASEAN Integration System of Preferences (AISP) is accelerating the integration of the CLMV countries into the regional market.

Regionalism through ASEAN membership also provides the Mekong economies an opportunity to pursue multilateralism. If the new member countries emulate the original ASEAN members and adopt a nondiscriminatory approach to regionalism by multilateralizing their trade preferences, the extent and pace of their integration with the global economy will be maximized. The new members will be able to avoid trade diversion, as well as trade, production, and investment deflection. They could also eliminate the tedious and costly implementation of rules of origin and measuring domestic content of their imports. This would be the first-best option.

But a myriad of political economy considerations may stand in the way of this first-best option. In light of this, the question is: Will the pursuit of discriminatory regionalism necessarily impair multilateralism? This need not be so for the GMS economies in AFTA. There are other ways through which regionalism can work as a vehicle to promote closer integration with the rest of the world.

Regional integration is bringing globalization to the doorstep of the Mekong through strong links of the original ASEAN countries with industrialized nations. The strategic location of the GMS region also provides opportunities for integration beyond the region. Location between the burgeoning economies of India and PRC gives significant potential to boost trade, tourism, and investment. The recent signing of agreements to establish free trade areas between ASEAN and these economies significantly increases the potential to exploit such opportunities. It also highlights how regionalism is promoting multilateralism by extending integration beyond the region's boundaries.

Some GMS economies are pursing globalization directly and independently through WTO membership, while others are seeking to join them in doing so. Thailand and Myanmar have been members for some time, while PRC and Cambodia joined only recently. The other GMS economies are aggressively pursuing membership. Since Lao PDR and Viet Nam have come a long way in their liberalization efforts through their active participation in subregional and regional cooperation initiatives, the most significant benefit of WTO membership for them may be through demonstration effects. WTO membership will signal to the rest of the trading world that these economies have successfully satisfied a demanding set of international trade and investment rules and guidelines.

Finally, the MREO assesses the external debt burden and analyzes its sustainability in the CLV countries (Cambodia, Lao PDR, and Viet Nam). Debt vulnerability in the CLV countries seems to largely be a legacy of their past. Its historical roots can be traced back to the command economies that operated during the Soviet era. A common feature in the composition of debt in Lao PDR, Viet Nam, and Cambodia is the significant share owed to the Russian Federation. In all of these countries, more than half the debt stock has historically consisted of Russian debt. All three countries have been negotiating with Russia on final disposition of this debt.

A significant breakthrough came in September 2000, when Viet Nam and the Russian Federation agreed to have most of the Russian debt written off, with the remainder serviced on highly concessional terms. This led to an agreement similar in principle between Lao PDR and Russia in June 2003. Although agreement on resolving Cambodia's debt to Russia is still pending, the breakthroughs in Viet Nam and Lao PDR give hope for a speedy resolution under similarly favorable terms.

Putting aside nonserviced debt (to Russia in Lao PDR and Russia and the US in Cambodia), debt as a share of GDP in 2002 ranged from less than 20% in Cambodia, to about 40% in Viet Nam, to 70% in Lao PDR. The external debt service ratio in 2002 ranged from a low of about 4% in Cambodia, to 8% in Lao PDR, to about 10% in Viet Nam. All debt service indicators in the CLV countries suggest that current debt levels appear sustainable.

Viet Nam's experience suggests that once the Russian debt is resolved favorably, the situation improves to such an extent that a country no longer looks vulnerable in terms of any of the stock or flow indicators of external debt. It is also unlikely that these countries will again face a debt overhang problem like with the Russian debt. The move toward a market-based economy, and the institutions that have emerged since the Russian debt was accumulated, stand as safeguards against a future repeat of such debt problems.

Thus, it is reasonable to conclude that the debt situation in the Mekong economies will be considered sustainable if the Russian debt is resolved favorably. Even with the Russian debt on the books, the debt situation can still be considered sustainable because the debt is not being serviced. So either way, it is fair to conclude that these economies are in a position to continue to absorb more lending, particularly if on concessional terms, and if the lending leads to improved productivity, policy reforms, and revenue generation in excess of servicing costs. Indeed, as transitional economies, further inflows of aid and loans will be essential to assist in their pursuit of economic development. Rather than adding to economic vulnerability, recent borrowings have worked to reduce it. This should continue.

I. INTRODUCTION

1. The inaugural issue of *The Mekong Region: An Economic Overview* (MREO) is designed to complement the Greater Mekong Subregion (GMS) Regional Cooperation Strategy Program (RCSP) of the Asian Development Bank (ADB) by providing the necessary economic context and background to support it. The MREO provides a detailed analysis of the topics covered in Chapter II of the RCSP, particularly in relation to external debt, and analyzes other key regional economic issues.

2. The MREO is organized as follows:

(i) We begin by reviewing recent economic performance, both at the regional and the individual country level.

(ii) Next, we review country-specific challenges before reviewing a number of common transitions that the region is undergoing. Managing these transitions, and responding effectively to the challenges that they pose, will significantly affect the future economic development of GMS.

(iii) We analyze how the different modalities of economic cooperation—subregional, regional, and multilateral—can contribute to overcoming these challenges. Particular attention is paid to items like delineating complementarities among the different modalities of economic cooperation, and identifying if and how subregionalism can promote regionalism or multilateralism, or how regionalism in turn can promote multilateralism. The question that we try to answer is whether subregionalism and regionalism can act as building, rather than stumbling, blocks to free and open trade and investment in the GMS.

(iv) Finally, we examine in detail the special topic for this inaugural issue: the question of external debt burden and sustainability in the transitional economies of GMS.

(v) A concluding section summarizes the main points.

3. We analyze how the different modalities of economic cooperation—subregional, regional, and multilateral—can contribute to overcoming these challenges. Particular attention is paid to such items as delineating complementarities among the different modalities of economic cooperation, and identifying if and how subregionalism can promote regionalism or multilateralism, or how regionalism in turn can promote multilateralism. The question that we try to answer is whether subregionalism and regionalism can act as building, rather than stumbling, blocks to free and open trade and investment in GMS.

4. Finally, we examine in detail the special topic for this inaugural issue: the question of external debt burden and sustainability in the transitional economies of GMS. A concluding section summarizes the main points.

5. The GMS comprises five countries and one province: Cambodia, Lao People's Democratic Republic (Lao PDR), Myanmar, Thailand, Viet Nam, and Yunnan Province of the People's Republic of China (PRC). The GMS has a combined land area of 2.34 million square kilometers (km^2). Its population was 257.5 million in 2002, and its population density was about 110 people/km^2. The nominal GDP of the subregion in 2002 was estimated at about $200 billion. The average per capita GDP, measured in purchasing power parity terms, was $3,288 in 2002.

II. RECENT ECONOMIC PERFORMANCE

A. Regional Overview

6. The GMS is one of the world's fastest-growing subregions. With the exception of Thailand, which was directly affected by the Asian financial crisis, growth has remained about 4% or higher in all of the economies for the past decade. GDP growth in all six economies was robust in 2002, ranging from 5.5% in Cambodia to 7.0% in Viet Nam (Table A2.1, Figure A2.1).[1] The GNP-weighted average growth for GMS in 2002 was higher than 6%, significantly higher than the average of 4.8% recorded in 2001. This figure is likely to have increased in 2003. Available data suggest that the trend of strong growth has continued in 2003 despite the outbreak of the Severe Acute Respiratory Syndrome (SARS) epidemic and the uncertainties induced by war in Iraq.

7. All economies except Cambodia are expected to have grown by about 6% or higher in 2003, with Viet Nam again topping the list at 7.1%. Cambodia's growth is likely to be about 5%, because of security concerns in early 2003 and ongoing political uncertainties. Various domestic and external factors have played a role in continuing this growth trend in 2003. Factors contributing to growth have been strong consumer spending, improved agricultural output induced by favorable weather, increased exports, and fiscal stimulus packages in many economies.

8. Except for Myanmar and Lao PDR, consumer price inflation remained low and manageable in the GMS economies during 2003 (Table A2.2, Figure A2.2). The low inflation resulted from a variety of factors including improved food supply, relatively stable exchange rates, and slow growth in money supply. Although inflation remains endemic in Myanmar, Lao PDR subdued some of its inflationary pressures late in 2003 by introducing a range of restrictionary fiscal measures.

9. All GMS economies except Thailand continued to have fiscal deficits during 2003, partly reflecting higher expenditures aimed at stimulating the economy (Table A2.3, Figure A2.3). Thailand posted its first surplus since the Asian financial crisis began. Difficulties in raising government revenues largely account for ever-increasing budget deficits in Lao PDR, Cambodia, and Myanmar. Difficulties with revenue collection continue to pose a threat to macroeconomic stability in Lao PDR and Myanmar; in Cambodia, the impact of revenue collection problems is mainly felt through the constraint it places on the Government's capacity to implement social and other expenditure programs.

10. In the external sector, exports surged in all economies in 2002 except for Myanmar. This trend has largely carried over to 2003, despite SARS and other global uncertainties. The increase has been particularly impressive in Thailand, Viet Nam, and Yunnan Province of PRC, due largely to improved external demand and, for Viet Nam, to high crude oil prices.

11. All economies except Thailand continue to run current account deficits, although none of the deficits appear nonsustainable (Table A2.4, Figure A2.4). Net foreign direct investments (FDI) in Thailand, Lao PDR, and Viet Nam increased sharply in 2003, after having slowed in almost all GMS economies in 2002.

[1] Myanmar's Ministry of National Planning and Economic Development reports 9.7% growth in 2002, but independent estimates are about 6%.

B. Cambodia

12. Cambodia's economy grew by 5.5% in 2002, down from 6.3% in 2001. Growth for 2003 is projected to have slowed to about 5% due to the impact of political uncertainties, the January 2003 riots, and the SARS outbreak. Although a growth rate of about 5% should be considered healthy, the trend has been consistently downward since 1999. The slowdown is significant, considering that growth averaged 7.3% from 1999 to 2002. The national elections, held in July 2003, have not yet resulted in formation of a new government. This continues to undermine investor confidence.

13. Cambodia faces a persistent and growing budget deficit, mainly because of difficulties in raising adequate revenues. In 2002, government revenues were only 11.1% of GDP, while expenditures accounted for 17.7%. The share of tax revenues was a low 7.8% of GDP. The budget deficit for 2003 is likely to exceed the Government's target of 6% of GDP, and may exceed 7%, particularly given the boost in spending associated with the national elections.

14. Inflation remains manageably low, increasing from 3.3% in 2002 to 1.2% in 2003 due to rises in the price of major food items and some utilities.

15. The trade deficit widened from $240 million in 2001 to an estimated $564 million in 2002. Imports grew by 6.5% compared with export growth of 6.0%. This produced a current account deficit of 8.1% of GDP, which was financed through official transfers and capital inflows, mainly concessional loans and FDI.

16. The riel continued to remain broadly stable against the dollar, but it constitutes only a small share of the money stock in this heavily dollarized economy. Estimates of the degree of dollarization vary, but many suspect it could be as high as 90% or more of the money stock.

17. Foreign currency reserves as the third quarter of 2003 ended were more than $0.7 billion, sufficient to cover more than 3 months of imports.

C. Lao PDR

18. The Government estimates that GDP growth in fiscal year (FY) 2003 (the FY ended 30 September) was 5.9%, little changed from the growth rate the previous 2 years. This is a favorable outcome given the SARS outbreak, which affected tourism to some extent. Concerns about the effect of unusually low rainfall on rice production in the upland areas were alleviated when late August and September rains broke the drought.

19. In FY2003, the Government's overall budget deficit was 7.8% of GDP. Government revenue as a share of GDP was 13.8%, while expenditure was 21.6%. The Government introduced a package of revenue and expenditure measures in late May 2003. The petroleum tax rate was doubled and excise tax rates on beer and tobacco were raised. On the expenditure side, the Government cut capital spending in projects considered ineffective or inefficient. These measures should help prevent a future deficit overrun, but further reform measures and improvements in revenue collection will be necessary.

20. Inflation was 10.6% in 2002, but rose to 15.5% in 2003. For the first quarter of 2003, inflation averaged 16.3%, then rose to almost 18% in the second quarter. Aside from the depreciation of the kip against the baht, price increases for basic necessities such as food, water, and electricity, as well as petroleum prices, contributed to this increase. But recent

monthly figures suggest that inflation has started to decrease, in line with Government efforts to reign in the budget deficit. Inflation dropped to 13.7% in November, and appears to have stabilized. Although this is an improvement over the first half of the year, it nevertheless suggests a continued need for close monitoring of inflationary pressures.

21. After dropping in 2002, both exports and imports grew strongly in 2003. In the first half of 2003, merchandise exports grew by 23%, while imports grew by 16%. The main contributors to this increase in exports were hydropower, timber, and garments which, combined, comprise about 80% of total exports. Lao PDR's traditional markets are Thailand, Vietnam, and European Union countries such as France, Germany, and Belgium where preferential trade arrangements drive much of the trade.

22. PRC has recently begun to emerge as an important destination for Lao exports, particularly forestry and agricultural products. Exports to PRC grew by about 50% in the first half of 2003 compared with the same period in 2002—from $12 million to $18 million. The United States (US) could also become a significant trading partner should Lao PDR be granted Normal Trade Relations in the near future.[2] The merchandise trade deficit is estimated to have decreased from about $200 million in 2002 to $140 million, while the current account deficit is estimated at about $57 million.

23. The kip depreciated by more than 10% against the dollar in 2003. The exchange rate is currently stable at about 10,500 kip to the dollar. Foreign exchange reserves increased to more that $190 million by mid 2003, which was sufficient to cover more than 4 months of imports of goods and services.

24. The value of foreign direct investment inflows for FY2003 rose by 67%, from $93 million in FY2002 to $155 million. This sharp increase is attributable to a gradual recovery in developing and improved domestic investment conditions, particularly improvements in the approval process. The main investors were from the region—Thailand, Viet Nam, and Malaysia—plus Australia. PRC is now emerging as a major investor, doubling its approvals from FY2002 to FY2003.

D. Myanmar

25. Data on Myanmar is sparse, and concerns have been raised over their reliability. Independent estimates suggest that economic growth for 2002 was about 6%, although the Ministry of National Planning and Economic Development reports 10% growth. In either case, that is down from the 11.3% reported in 2001. Growth in 2003 is unlikely to meet the Government's target of 10%.

26. Inflation averaged 57% in 2002, and appears to have eased somewhat in 2003, with year-on-year inflation in September 2003 of 24%.

27. Government estimates suggest that the fiscal deficit decreased from 5.9% of GDP in FY2001 to 4.1% in FY2002. The accelerating inflation rate brings the reliability of this estimate into question.

28. Because of both the political and economic situations, FDI has continuously declined over the past 4 years.

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[2] Regular updates on progress in Lao People's Democratic Republic (PDR)'s movement toward Normal Trade Relations (NTR) status with the United States (US) can be found at http://www.us-asean.org/laos.asp.

29. Gross official reserves are estimated to have increased from about $620 million in 2002 to $780 million in 2003. That would be sufficient to cover about 4 months of imports.

E. Thailand

30. The momentum associated with the solid growth of 5.2% in 2002 more than carried through to 2003. Growth for the first half of 2003 averaged a robust 6.3%, increased to 6.6% in the third quarter and shot up to 7.8% in the fourth. The sharp increase in the final quarter resulted in overall growth for 2003 of 6.7%. Thailand is now growing at rates not seen since the Asian financial crisis. Strong private consumption spending, coupled with a remarkably resilient export performance, drove most of the expansion in 2003.

31. For the first time since the Asian financial crisis, the budget recorded a surplus amounting to 0.6% of GDP for FY2003 (ending 30 September 2003), and a cash surplus of 0.6% of GDP, including the nonbudgetary balance. This is a massive turnaround from the deficit of 2.2% of GDP in FY2002. The surplus was mainly the result of buoyant tax receipts, accruing from strong economic growth.

32. After growing by almost 20% in the first half of 2003, export growth slowed but remained healthy at 11% in the third quarter of 2003. Similarly, import growth of 15.5% in the first half of 2003 moderated to 11.8% in the third quarter. Strong growth in both exports and imports in the fourth quarter resulted in exports growing by 18.6% in 2003, and import growth of 17.1%. This produced a merchandise trade surplus of $4.2 billion for 2003, up from the $2.7 billion recorded in 2002.

33. Aided by a recovery in tourism in the second half of 2003, the current account surplus increased to $5.6 billion for the first 9 months of 2003—18% higher than that of a year before. For 2003 as a whole, the current account surplus is expected to be about 6% of GDP, similar to that in 2002. But the overall balance of payments swung slightly into deficit ($322 million) for the first three quarters of 2003, wiping out the $3.1 billion surplus of a year before after prepayment of the International Monetary Fund (IMF)-led “crisis” loan package.

34. Inflation increased but continued to remain low in 2003. Consumer price inflation rose by 1.8%, while "core" inflation (excluding food and energy items) rose by only 0.2%.

35. The baht firmed in 2003, and ended the year at less than 40: 1 to the dollar. By early February 2004, the baht was trading closer to 39: 1. Foreign currency reserves rose to end 2003 at slightly less than $41 billion, which is more than twice the level of short-term debt, and equivalent to almost 7 months of imports.

36. Net flows of foreign equity investment also rose sharply in 2003. During the first 9 months, net equity flows totaled $1.1 billion, up from $292 million for all of 2002. Japan was the largest net investor, accounting for 44% of the foreign investment, followed by the European Union, with 34%. Most investments were in manufacturing and trade-related activities.

F. Viet Nam

37. GDP grew by an impressive 7.1% in 2003, up from 6.5% in 2002, making Viet Nam’s economy one of the world’s fastest growing. Strong consumption and investment spending,

coupled with robust export performance, underpinned this performance. Strong growth is expected to continue in 2004, remaining higher than 7%.

38. Strong growth also resulted in increased collection of government revenues. In 2003, revenues increased by 11.8%. The value-added tax contributed 29% of the revenues, corporate income tax about 28%, and trade taxes about 21%. Government spending also increased as a result of reform measures associated with bank recapitalization in the first half of 2003, and recently in conjunction with hosting the Southeast Asian Games. Total Government expenditure in 2003 rose by 16.1%. This resulted in an overall budget deficit of 4.7% of GDP in 2003, up from 3.5% in 2002.

39. Exports increased by $19.3 billion in 2003, while imports rose by $22.6 billion, causing a $3.1 billion trade deficit. Strong import growth in 2002 turned the current account into deficit for the first time in 3 years. That trend continued into 2003. The increased trade deficit contributed to 5.7% of GDP—almost double the account deficit in 2003.

40. Inflation remains low and manageable, despite rapid economic growth. The consumer price index increased by only 1.8% in the first half of 2003, and was expected to average less than 4% for the entire year. That is about the same as in 2002.

41. The exchange rate remained relatively stable in 2003, with the dong depreciating against the dollar by an average of only 3.5%.

42. FDI commitments continued to increase in 2003, rising by almost 40% in the first 9 months compared with the same period in 2002.

43. Gross international reserves, including gold, increased to about $4.6 billion by the end of 2003, covering more than 2 months of imports.

G. Yunnan Province, PRC

44. Data for Yunnan, as a PRC province, are limited compared with data for GMS member countries.[3] Yunnan's growth averaged a robust 9.3% from 1992 to 2001. Growth remained higher than 10% yearly from 1992 to 1996, and then the trend went downward. 2001 growth slowed to 6.5%, and similar growth was expected in 2002.

45. Per capita income in 2002 was $2,881—second in terms of purchasing power parity only to that of Thailand. Purchasing power parity more than doubled from 1992 to 2002, and has increased faster than that of other GMS members.

46. Despite robust growth Yunnan Province has experienced deflation over the past few years. Consumer prices fell by 0.9% in 2002. The slowdown in growth since the mid-1990s may account for the deflation to some extent, as consumer price inflation had averaged higher than 20% in the high growth years of the mid-1990s. Similarly, the average growth in broad money over the deflation years of 2000–2002 was less than 16%, compared with about 34% from 1994 to 1996.

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[3] The People's Republic of China's (PRC) National Bureau of Statistics of China, however, publishes the *China Statistical Yearbook Yunnan Province, PRC* that contains a range of provincial information.

III. COUNTRY-SPECIFIC CHALLENGES

A. Introduction

47. As economies in transition from centrally planned to market economies, the CMLV countries face common problems. But each country is at a different stage in this transition, and other country-specific factors suggest differences in the types of challenges that each country must address. At the other end of the spectrum lies Thailand, a fully-fledged market economy, but one still grappling with many of the challenges of a developing Asian country. The fight against poverty is a common challenge that the CLMV countries and Thailand face. Although poverty has regional dimensions (high rates of poverty are often concentrated in bordering regions) (Figure A2.5), the challenge is essentially national, and the response to it usually requires country-specific actions.

48. Next we review the major, and sometimes unique, challenges that each CMLV country and Thailand face, before turning to some common transitions they are currently undergoing.

B. Cambodia

49. In many ways, Cambodia is still recovering from the devastation of the Khmer Rouge period. Effects of the destruction of social, economic, and political institutions, as well as physical infrastructure, during the Khmer Rouge period are still evident. Apart from rebuilding both social and physical infrastructure, the development of human resources is a significant challenge facing the country. But progress has been made, and Cambodia is now shifting its focus from rehabilitation or reconstruction to the pursuit of economic advancement through growth and development.

50. Poverty incidence remains high and social indicators are among the lowest in the region. Estimates of poverty incidence vary by source and method of measurement, but tend to range from 35% to 40%. An estimated 15% to 20% of the population lives in extreme poverty. Cambodia's urbanization rate is low, so almost 90% of the poor are rural (Table A2.5). The percentage of the population below the poverty line is lowest, from 10% to 15%, in Phnom Penh, and highest, from 40% to 45%, in rural areas. The Plains and the Tonle Sap Basin account for more than 80% of all poor. Poverty is most severe in both the urban and rural Plateau/Mountain Zone, despite the fact that incidence of poverty is relatively low there. Measured by the human development index (HDI), Cambodia's improvement of the poverty situation, since 1990, has been the least of all GMS economies (Table A2.6, Figure A2.6). The Government launched its first National Poverty Reduction Strategy in 2002.

C. Lao PDR

51. Lao PDR is the least developed of the GMS economies. The sparsely populated country is land-locked, with a difficult terrain. Laos has a narrow resource base, which limits its capacity to diversify its bases for production and export. Institutions remain weak and human resources underdeveloped. Laos has initiated a comprehensive reform program, but the pace has been slow, so transition to a fully-fledged market economy remains a long-term challenge. But things have improved over the past few years, with the Government implementing various revenue and expenditure measures, for instance, to address macroeconomic instability. After a number of delays, and partly as a reflection of these improvements, the IMF successfully concluded the third review of the Poverty Reduction Growth Facility in 2003.

52. The Lao Expenditure and Consumption Survey II (LECS II), conducted in 1997–1998, estimated that 39% of the population lived below the national poverty line of $1.50 a day. Preliminary results from the LECS III survey (to be released in April 2004) suggest that poverty incidence has fallen to about 30%. This sharp reduction in poverty incidence, over 5 years, is associated with consecutive years of strong economic growth. Although Lao PDR's HDI remains the region's lowest, about 0.53 in 2001, it has increased the most, in percentage terms, since 1985 (Table A2.6, Figure A2.6).

53. Poverty in Laos is not evenly distributed, tending to be higher and more concentrated in the northern region. Although evidence suggests that economic growth has had a positive effect in reducing poverty, increased inequality has diluted the gains that the poor might have expected to receive from economic growth.

54. The National Poverty Eradication Program and the Poverty Reduction Strategy Paper include specific policies to address poverty. Prioritized action plans and their implementation are critical to their success.

D. Myanmar

55. The economy of Myanmar is fraught with distortions, ranging from a highly managed foreign exchange regime to a profusion of controls on production and exports in agriculture, its most important sector. The political situation causes Myanmar to have limited access to badly needed assistance from international donor agencies.

56. The only official headcount index of poverty in Myanmar, done in 1997, put its incidence at 22.9%. This is surprisingly low when compared with countries with similar per capita incomes. It also appears somewhat inconsistent with other human development indicators, such as life expectancy (Table A2.7). Although this low figure for poverty may reflect Myanmar's rich agricultural legacy, the data may be subject to error.

E. Thailand

57. In many ways, Thailand is the gateway to GMS. Thailand constitutes the subregion's most developed and largest market, and is an important source of knowledge and capital resources. Thailand is also a communication and transportation hub, and is the vantage point from which many potential foreign investors view GMS. Despite recent impressive growth, poverty remains a significant problem, particularly in the northeastern region bordering Lao PDR, and regions bordering Cambodia and Myanmar (Figure A2.5). There is also a need to continue reforms to further consolidate growth performance. Completion of the restructuring of the banking and corporate sector remains vital for the recovery of business investments and medium-term prospects for the economy.

58. Thailand has made substantial progress in reducing poverty over the past two decades. But the 1997 financial crisis interrupted this momentum. Its impact on the poor was severe. Estimates of poverty vary according to source, and how it is measured. Government estimates suggest poverty incidence increased from about 11.4% in 1996 to 15.9% in 2001. Poverty is likely to have fallen appreciably since 2001 with a return to strong economic growth. But rural regions, particularly in the northeast, have not benefited as much from economic growth as Bangkok. Measures to promote greater geographic balance in the creation of economic opportunities deserve priority attention from the Government. Thus, sustained poverty reduction will require more than rapid economic growth; in many ways, it will hinge on reversing growing

trends toward income inequality. Urban and rural poverty seemed relatively evenly distributed in 1993, by 2000 urban poverty incidence had dropped to 1.5% while rural poverty had increased to more than 17% (Table A2.5)

59. In the Ninth National Economic and Social Development Plan (2002–2006), the Government has committed itself to intensifying the fight against poverty, and has set a target of reducing the poverty incidence to less than 10% by 2006. With this target in mind, the Government is trying to address the poverty issue mainly through its fiscal spending program. For example, the Government introduced a substantial package of farm-, village-, and small enterprise-oriented programs designed to expand productive opportunities for low-income groups. Also, a low-cost universal health scheme has been introduced to cover the uninsured. The Government also introduced an unemployment security fund to provide a safety net for employees who are laid off, effective 1 January 2004.

F. Viet Nam

60. Viet Nam and Yunnan Province in PRC are the most economically advanced of the GMS's transitional economies. Viet Nam has steadily progressed toward a market economy. Nevertheless, the pace of reforms, including those relating to governance, should be accelerated.

61. Viet Nam approved its Comprehensive Poverty Reduction and Growth Strategy (CPRGS) in May 2002. The CPRGS has been considered an international best practice not only because of its emphasis on economic growth as a means to reduce poverty, but also for its inclusive, participatory process of preparation and implementation. Based on 2002 household survey data, about 29% of the population spent less than a dollar a day compared with 58% in1993 and 37% in 1998. This implies that about 20 million people have been lifted from poverty in less than a decade. The broad improvement in living standards was largely due to job creation by the private sector, both formal and informal, and further commercialization of agriculture.

62. The rural poverty headcount index remains high, about 36% in 2002, but this is a sharp reduction from about 57% in 1993 and 45% in 1998 (Table A2.5). Improvement in the urban poverty rate is even more impressive, dropping from almost 26% in 1993 to 9% in 1998 to 6.6% in 2002. The HDI has also risen sharply, from about 0.58 in 1985 to almost 0.69 in 2001 (Table A2.6, Figure A2.6). Geographically, the most dramatic drop has occurred in the Mekong Delta, with incidence falling from 37% in 1998 to about 23% in 2002. But poverty in the Central Highlands remains high, at 52%. Demographically, the food poverty situation of ethnic minorities has changed little, remaining at about 40% of the populations, while the general poverty rate among ethnic minorities is almost 70%.

IV. THE GMS IN TRANSITION

63. The future of GMS, apart from addressing these country-specific challenges and problems, will also depend on how successfully its member economies manage a number of critical transitions. These transitions are at different stages in different places, but are present to some degree in most.

64. The first important transition underway is in the changing role played by the state and markets. There is growing acceptance that markets and the private sector can do many things better than Government. Consequently, the private sector's contribution to total economic activity has grown faster than the state sector's contribution in most GMS economies. Going forward, the space occupied by the private sector and by markets is likely to expand. Reforms may also encourage activities to migrate from the informal to formal sectors. Increasingly, this will allow governments to refocus their energies and scarce resources to making the enabling environment right and delivering services that markets cannot or will not provide.

65. A second important transition is the increasing diversification of the structure of most GMS economies. Subsistence agriculture is giving way to commercialized agriculture, and the share of agriculture in total income is beginning to decline as emerging manufacturing activities, including agro-processing, expand. With this transition will be an accompanying drift of people from the countryside to towns and cities.

66. Changes on the social front will also affect economic conditions and create challenges in managing economic performance. Active family planning and maternal health programs are lowering fertility rates in most of the GMS. Populations are still young, but the size of the population of working age will bulge over the next two decades. This is already happening in Viet Nam. Low-productive, subsistence agriculture will not be able to fully absorb new entrants to the labor force in the future. Although economic diversification is already taking place, much is as a natural process associated with economic growth. The ongoing pattern of diversification is largely both a cause and a consequence of rising incomes and greater prosperity. But the question is whether the pace of change is rapid enough to absorb the sharp increase in the labor force expected in the future. Unless specific interventions complement this natural process of diversification, it is unlikely that a large rise in unemployment can be avoided. This is why investments in basic skills and competencies, policy reforms that induce structural change, and rapid private sector development are so important.

67. The GMS economies are becoming more "open" economically, which is important in the development of markets. In Cambodia, Thailand, and Viet Nam, the openness ratio, measured as the ratio of total trade to GDP, already exceeds 100% (Table A2.8). The weighted-average openness ratio for GMS (excluding Myanmar and Yunnan Province) more than doubled from 48% in 1992 to 99% in 2002. Informal cross-border trade has always been important. There was a temporary pause during the Asian financial crisis, but growing integration has resumed within the subregion in terms of formal trade and investment flows.

68. Although many of the transitions are occurring through reform programs that the GMS economies have embarked upon, their full realization is in no sense preordained. Much will depend on the choices made going forward, and how policy makers address the challenges that they face collectively, and within their own national boundaries.

69. Occurrence of these transitions following a return of peace to the region is no coincidence. Looking back, we can see how a legacy of conflict has arrested connectivity within

the region, between the region and the rest of Asia, and beyond Asia to the rest of the world. But that is now changing. Over the past decade, peace has provided an opportunity to draw the GMS economies closer together. Multilateral financial institutions (MFIs) such as ADB are working with the governments of these economies to address such challenges through a variety of interventions at the national level. The approach taken by the ADB for instance is articulated in the Country Strategy and Program and its Updates.

70. We focus on examining how the GMS economies may face challenges collectively. We concentrate on the different modalities of economic cooperation, and how they may contribute, or can be made to contribute, to overcoming those challenges and taking the region forward toward greater prosperity and better livelihoods for its citizens.

V. ECONOMIC COOPERATION AND INTEGRATION

A. Introduction

71. Although the GMS region is characterized more by diversity than by similarity, important and growing interrelationships within the region link the economic prospects of individual economies. To some extent, the differences themselves contribute to the growing linkages. Many traditional factors that motivate economic cooperation are found within GMS. Complementarities in resources and income levels suggest important opportunities for intraregional trade and investment. The trading relationship between Thailand and Lao PDR is an illustrative example of these drivers at work. Differences in factor endowments and levels of economic development explain much of the trade pattern between the countries. Thailand is Lao PDR's most important trading partner. Thailand provides a significant portion of Lao PDR's demands for manufactured good, and buys a significant share of Lao PDR's resource-based exports such as hydropower and timber.

72. Economic cooperation can lower transactions costs and align resources with comparative advantage more closely by reducing structural and institutional impediments to movements of goods, people, and capital. Also, GMS partners can exploit economies of scale by acting together, increasing efficiency in some sectors and making activities possible that might not be otherwise.

73. Economic cooperation and integration are taking place at three levels: subregional, regional and multilateral. How we define each of these geographic groupings determines our definition of the types of initiatives in economic cooperation and integration. We define the subregion to consist of the grouping of economies that are GMS members. The region is defined to include all 10 countries that are currently members of the Association of Southeast Asian Nations (ASEAN). Multilateralism or globalization is defined as a residual, and refers to countries outside the subregion and region.[4]

B. Subregionalism

74. At the subregional level, the GMS program is helping the Mekong economies forge the links and trust that are vital to exploit complementarities, to address shared problems, and to generate economies of scale. To place the GMS program in proper perspective, and to better understand how it has affected subregional cooperation, it is useful to reflect on history, tracing its roots and its evolution. The origins of GMS can be traced to the 1957 establishment of the Mekong Committee, which then comprised the four riparian countries of the lower Mekong Basin. But the region was racked by conflict, so there was little progress over the following three decades. The process gained substance only in 1992, when ADB initiated a formal program of cooperation among the six current GMS members. Building ownership has been a gradual process, but the GMS Leader's Summit in September 2002 affirmed strongly that the program now has momentum and is fully owned by GMS members.

[4] Although Yunnan Province of PRC is part of the Greater Mekong Subregion (GMS), we include the PRC as a whole in the residual definition of global because Yunnan is only one province of a vast country. This definition of global is also more than one of mere convenience when considering the strong identity associated with the definitions of subregion and region. For example, it would be equally unusual to include countries such as Malaysia, Singapore, or Indonesia in our definition of subregion as it would to include the US, India, or Australia in our definition of region.

75. Essential infrastructure remains underdeveloped in the GMS economies. ADB is playing a catalytic role in promoting trade and spreading development benefits throughout GMS through priority initiatives such as the East-West, North-South, and Southern Economic corridors. Power transmission interconnection options and the development of fiber optic transmission links—both covered through the GMS flagship programs on power and telecommunications—also fall within the geographic scope of these corridors.

76. The development impacts of these projects are numerous. For example, the impact of the roads sector can be seen through in easier access to services and markets as a result of significantly reduced transport times and increased load carrying capacities. As a result of greater ease of physical linkage, small towns are beginning to flourish and expand, new businesses are being established along many of the routes, and new markets are emerging, bringing a host of new entrepreneurial and employment activities.

77. These developments can be observed, for example, along the East West Economic Corridor in towns such as Seno, Dong Hen, Xetah Moak, and Mouang Phin. Such changes underscore the key impediments that high costs for internal land transportation cause for poor landlocked countries like Lao PDR. These impediments are also significant in Cambodia and, to a lesser extent, in Viet Nam where they isolate communities and constrain the growth of markets and employment. ADB's interventions through its GMS program recognize that overcoming these impediments requires improvements in infrastructure as well as the introduction of complementary polices to facilitate the shipment of goods and services.

78. The facilitation of cross-border trade and investment is another key feature of increasing subregional economic integration in GMS. The GMS program supports a range of measures to facilitate trade and investment that are designed to promote integration. These include improving procedures for customs clearance and increasing transparency in its application, and enhancing technical skills to improve the application of various regulatory systems. ADB is currently implementing a regional technical assistance to facilitate cross-border trade and investment. It includes the pilot testing of single-stop procedures of customs inspection at selected border sites. The GMS program is also helpings member economies prepare for a single GMS visa system. Besides promoting tourism and reducing the direct cost of cross-border control and management, a single-visa system would have indirect but positive effects on trade and investment.

79. A number of other economic cooperation initiatives currently operate in the subregion. These include the Development Triangle Initiative (DTI) involving Cambodia, Lao PDR, and Viet Nam; and Thailand's Economic Cooperation Strategy (ECS) that promotes development and closer integration with neighboring Cambodia, Lao PDR, and Myanmar. These initiatives complement the GMS program. For example, DTI is included in the GMS Southern Economic Corridor program, while the Chiangrai to Kunming highway of the ECS is cofinanced by ADB and PRC. There has also been a plethora of bilateral trade agreements (BTAs) in the broader region of late, with Singapore leading the region in concluding such deals. Thailand is the only GMS country that has been pursuing this option in any significant way, although Viet Nam has concluded a BTA with the US and so has Lao PDR.[5] Thailand concluded its first bilateral agreement with Bahrain in 2003, and has made significant progress in negotiating bilateral deals with the PRC, India and Australia.

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[5] Lao PDR's BTA with the US will become effective only after the Normal Trade Relations (NTR) status issue is resolved. This issue is discussed in more detail in the section on Multilateralism.

1. Emerging Trade-Investment Nexus

80. The impact of interventions that involve the development of essential infrastructure and measures to facilitate trade and investment are already being reflected in trade and investment statistics for the subregion. Cross-border trade among the six GMS economies has increased sharply. For example, recorded cross-border exports, in bath, from Thailand to Cambodia, Lao PDR, and Myanmar combined grew by an annual compound growth rate of more than 44% in 2002. Thailand's imports from its three neighboring countries, Viet Nam, Laos, and Thailand, increased by an annual compound growth rate of almost 10% from 2000 to 2002. More than two-thirds of Lao PDR's trade is with other GMS economies; more than a third is with Myanmar, and about a fourth is with Cambodia (Table A2.9). But a significant portion of trade among the GMS economies is not recorded. The nature of this type of trade makes it difficult to know its magnitude, but estimates range from about 30% to 50% or more as much as the total recorded trade.

81. The trend is similar for intra-GMS net FDI flows. Net FDI flows from the six GMS economies to Cambodia, Lao PDR, Myanmar, Thailand, and Viet Nam combined rose sharply from $130 million in 2000 to about $210 million in 2002. The PRC's savings can also potentially act as an important source of capital for GMS. The same can be said of Thailand and several other ASEAN countries, such as Malaysia and Singapore, which already have sizeable investments in the region. Thailand is already the largest investor in Lao PDR, and Malaysia has sizeable investments in Cambodia and Viet Nam.

82. That trade and investment are growing hand-in-hand in the subregion is no coincidence. Early signs of a trade-investment nexus are emerging whereby trade not only encourages investment, but investment, in turn, encourages trade. This is a favorable circle that links back to economic growth. For instance, not only is Thailand the largest investor, but also the most important trading partner, for Lao PDR. Looking at the experience of the original ASEAN countries, we can see how the trade-investment nexus catalyzed their rapid industrial development and structural change. Foreign investment in internationally integrated systems of production such as electronics and motor vehicles has transformed the economies of the original ASEAN countries from predominantly agricultural to manufacturing-based. In the future, the GMS economies will need to tap into this flow of funds to fuel their growth and development.

83. Rapid development brings changes in factor prices and shifting comparative advantages. As wages rise in the original ASEAN countries, and as long as macroeconomic performance and institutional, regulatory, and legal systems continue to strengthen in GMS, then GMS will be well placed to receive these types of investments. The GMS program has a vital role to play in ensuring that this occurs sooner rather than later. So do the initiatives associated with promoting regional cooperation and multilateralism.

2. Regionalism and Multilateralism Through Subregionalism

84. But are these intensive efforts at promoting subregionalism at the expense of openness? In other words, do efforts to increase subregional integration run the risk of making the subregion more inward looking? This is highly unlikely because the GMS program is a classic case of *market* as opposed to *institutional* integration. While institutional integration is characterized by legal agreements and institutional arrangements that promote preferential trade among members of the agreement, market integration relies on nonofficial institutions that provide regional public goods that reduce transaction costs associated with the international movement of goods, services, and other production factors.

85. Although the hardware and software initiatives of the GMS program are mainly directed at promoting trade and investment in the subregion, nothing in their design or application confines their impact to the subregion. These public and quasi-public goods, once provided within or for the subregion, will also improve economic relations with the ASEAN region as a whole. In other words, subregionalism also drives regionalism. Emerging transport networks and economic corridors in the subregion are transforming its economic geography. Trade and investment facilitation measures that are nondiscriminatory and World Trade Organization (WTO)-consistent are being pursued subregionally. They complement measures being pursued by the ASEAN Free Trade Area (AFTA). Thus, directly or indirectly, countries outside the subregion will also have access to these initiatives and measures, so they will contribute on a general level to increased trade and investment.

86. Although the vast majority of the positive spillover effects currently appear confined to the region, there are already signs that they are beginning to spread to outside countries. Over time, we should observe that subregional initiatives not only promote regionalism, but also indirectly contribute to multilateralism as trade and investment increase globally. The GMS program has helped these countries become more effective ASEAN members. This, in turn, will help them become more effectual and visible members of the global community. But these interrelations operate not only in terms of outcomes, but also in the process of moving toward these outcomes. For example, measures to facilitate subregional trade and investment complement many of the liberalization measures being pursued as part of AFTA membership. This, in turn, helps some AFTA members prepare for WTO accession.

C. Regionalism

87. At the regional level, ASEAN and AFTA are driving trade liberalization and the opening of markets. All Mekong economies except Yunnan Province are ASEAN and AFTA members. AFTA has been the driving force behind regional trade liberalization in the Mekong economies. An agreement has been struck for PRC to join AFTA, so Yunnan will be a key region through which closer links will be forged between PRC and the current GMS members of ASEAN. The impact of trade liberalization through reciprocal trade preferences associated with AFTA membership may be observed most markedly between Yunnan Province and the Mekong region.

88. Tariffs have already fallen sharply for a wide range of commodities, and the CLMV countries are getting closer to their target dates when 0–5% tariffs will apply to most intra-ASEAN trade. For Viet Nam, this deadline is only about 2 years away, in 2006. Lao PDR and Myanmar must apply tariffs by 2008 and Cambodia, by 2010. Those countries' combined inclusion lists (ILs) now comprise 72.2% of their total tariff lines, in contrast to 64.3% in 2002. In terms of tariffs, the rates of Common Effective Preferential Tariff (CEPT) on 60.6% of products that the CLMV countries trade in the region is already within the 0– 5% tariff band.[6] The average CEPT rate for the CLMV countries is now 6.2%, down from 6.8% in 2002. By late 2004, the ILs

[6] The CEPT scheme, the centerpiece of AFTA, covers all manufactured and agricultural products (both processed and unprocessed). The CEPT scheme requires member countries to categorize products into four lists: Inclusion List (IL), Temporary Exclusion List (TEL), Sensitive List (SL), and General Exception List (GEL). All products, except those in the GEL, must eventually be transferred to the IL, where their tariffs must be reduced to 0–5% over a predetermined time frame. The timelines associated with the transfer of products from the SL to the IL is more generous than from the TEL to the IL. In fact, products from the SL are first transferred to the TEL before ending up in the IL.

of the CLMV countries will probably cover 76.8% of their tariff lines. Of these, 66.7% will probably have tariffs within the 0–5% band.[7]

89. Besides having tariff lines with strictly reciprocal preferences, the AISP was initiated to accelerate integration of the CLMV countries into the regional market for trade in goods. At the 15th AFTA Council Ministerial Meeting in 2001, the original ASEAN members agreed to unilaterally extend tariff preferences to ASEAN's new members beginning 1 January 2002. This move is unprecedented for ASEAN, which has always operated on the basis of equal partnership. Although the AISP is implemented bilaterally and voluntarily, it is based on products that the CLMV countries themselves propose—not by the providing countries. This provision was designed to avoid the so-called "snow plow effect," whereby providing countries tend to extend preferences on tariff lines where there is little or no intra-regional trade.

90. At inception, it was estimated that AISP would provide unilateral preferences equivalent to about $400 million of CLMV exports. But the list of eligible tariff lines has grown dramatically since then. By September 2003, about 1,200 unilateral tariff lines from Cambodia, Lao PDR, Myanmar, and Viet Nam were eligible for tariff preferences in Brunei Darussalam, Indonesia; Malaysia; the Philippines; and Thailand because of this scheme.

1. Multilateralism Through Regionalism

91. Unlike the GMS program of subregional cooperation, AFTA clearly falls within the textbook definition of institutional—as opposed to market—integration. In essence, AFTA is a preferential trading arrangement based on a legal agreement that prescribes tariff reductions on a purely discriminatory basis. Although AFTA members must give trade preferences on a reciprocal basis and in accordance with a predetermined time frame, nothing prevents members from voluntarily extending the same preferences to nonmembers. This is largely what the original ASEAN members have been doing by embracing the concept of "open regionalism."

a. Multilateralism Through Open Regionalism

92. To minimize trade diversion, the original ASEAN members have been reducing their external tariffs, or tariffs applicable to non-ASEAN members, in conjunction with reductions on intra-ASEAN trade. This has minimized the margin of preference, or the difference between intra- and extra-ASEAN tariff rates, and thus minimized the potential for trade diversion. Furthermore, because the preferential tariff reduction schedules have been ambitious and rapid, AFTA has been the driving force behind speeding the pace of multilateral trade liberalization in the original ASEAN member countries. In this way, AFTA's greatest achievement may have less to do with what it prescribes or mandates, but rather what it promotes indirectly through the long-standing commitment of its members to the concept of open regionalism.

93. Emulation of the approach taken by the original members would be in the interest of the Mekong economies. Indeed they must emulate this approach if they are not to be left behind, and if they are to succeed in deepening regional integration. Regionalism through ASEAN membership could then provide the GMS economies with an opportunity to pursue

[7] For ASEAN 10, 92.1% of tariff lines would be in the IL by the end of 2004, of which 91.1% would have tariffs ranging from 0 to 5%.

multilateralism aggressively, and thus allow regionalism through AFTA to be a building, rather than stumbling, block toward free and open trade.[8]

94. There are reasons apart from minimizing trade diversion why the new member countries should emulate their predecessors in concurrently bringing down external tariffs. The freedom of members of a free trade area (FTA) to set their own barriers against trade with nonmembers raises the possibility of trade, production, and investment *deflection*.[9] Trade deflection occurs when imports enter the FTA via the member country with the lowest tariff on nonmember trade. Trade deflection distorts the region's trading patterns with the rest of the world, and deprives the member country that eventually consumes the import of tariff revenue. In the case of the GMS, revenue is likely to be lost to another member like Singapore, which is virtually a free trade port.

95. Production deflection will occur if the manufacture of products containing imported inputs shifts to countries that have lower tariffs on the inputs, because differences in tariffs outweigh differences in production costs. This is detrimental to economic efficiency and welfare, since the pattern of productive activity will be based on differences in duties rather than on comparative advantage. The deflection of production may also affect the pattern of international investment. If differences in tariffs outweigh differences in production costs, tariffs will dictate investment decisions. Investment deflection will reinforce detrimental effects on welfare and efficiency associated with production deflection. Although the GMS economies may not currently be subject to much production or investment deflection, because most are still relatively underdeveloped and do not currently compete with the other ASEAN members for the same types of investments, they could avoid it in the future by multilateralizing their AFTA tariff preferences.

96. To deal with potential trade, production, and investment deflection, AFTA imposes "domestic ASEAN content" requirements based on "rules of origin." These rules limit regional trade preferences to commodities that incorporate a minimum of 40% domestic ASEAN content. At best, application of these rules can only limit, but not eliminate, trade, production, and investment deflection in AFTA. But rules of origin are notoriously difficult to police, and the administrative burden can be substantial. Not only is the origin of a product difficult to determine in this era of increasing internationalization of production, but the transaction costs resulting from the extensive documentation associated with this cumbersome process could nullify any benefits coming from freer intra-regional trade. In many of the GMS economies, the administrative costs associated with implementing rules of origin or measuring domestic content could be crippling, or almost impossible.

[8] Whether the worldwide proliferation of regional trading arrangements will eventually integrate, rather than fragment, the world economy remains a separate and open question.

[9] Unlike a Customs Union (or Common Market or Economic Union), FTA members are not required to pursue common external commercial relations such as the adoption of a common external tariff.

i. Concerns Over Open Regionalism: Competitive and Revenue Effects

97. Some major concerns of the GMS economies in multilateralizing their tariff preferences relate to perceived negative impacts on domestic production, and government tariff revenue collection. The fear for domestic production is that, if liberalization were to proceed multilaterally rather than regionally, a flood of imports might wipe out some industries. A number of industries in the transitional economies of the GMS are considered by some to be in their infancy, thus requiring protection for survival. But this issue relates to protectionism, not whether liberalization should be preferential or multilateral once the decision has been made to liberalize. If grounds for protection based on the infant industry argument are valid, then such industry should be quarantined from both preferential and multilateral liberalization until it has developed sufficiently to survive without protection. AFTA provides for a more gradual phasing in of tariff reductions for such industries by allowing them to be placed in the Temporary Exclusion List (TEL) and Sensitive List (SL). For other industries, there is no reason to fear multilateral liberalization; to the contrary, it ensures that consumer welfare is maximized by enabling imports to be sourced internationally from the lowest-cost producer. So multilateralizing preferences should not jeopardize production of so-called sensitive industries in these economies, because all that is being recommended is uniformity in provision of tariff reductions to all trading partners, with no change in time frame of liberalization schedules or range of products covered.

98. Another major concern about multilateralizing of tariff reductions is that it might further erode revenue from trade taxes associated with AFTA-based trade liberalization. In other words, it is expected that a two-tier tariff rate—a CEPT rate for the intra-ASEAN producer and a higher Most Favored Nation (MFN) rate for extra-ASEAN producers—will mitigate total revenue loss somewhat. But a significant difference between the two rates would cause a strong incentive for trade deflection. This would simply result in revenue being lost altogether to the member country with the lowest external tariff, which in this case is most likely Singapore. In short, if trade deflection occurs as a result of the dual tariff system, then tariff revenue collected by the importing country could actually be lower than if the tariff reductions were multilateralized.

99. Apart from this, maintaining a system whereby two rates apply to each (if not most) tariff lines also increases the potential for rent-seeking behavior. It is an open secret that some portion of revenue associated with trade taxes is collected privately rather than publicly. This is reflected in the high estimates of the share of informal cross-border trade in GMS. A higher MFN rate compared with the CEPT rate will provide a new avenue through which private rents are extracted, with little or no change to public customs revenue collection. Indeed, reducing tariffs would remove some of the incentive for smuggling. This effect would probably be higher if the reduction is applied on a nondiscriminatory basis. Under certain conditions, such tariff reductions could even result in increased tariff revenue collections (Appendix 1). Thus, concerns about potential revenue loss should not stand in the way of these economies multilateralizing their CEPT tariffs and offering them to all trading partners on a nondiscriminatory MFN basis.[10]

[10] This recommendation to multilateralize preferences should not jeopardize production of so-called sensitive industries. As noted in an earlier footnote, AFTA provides a more gradual phasing in of tariff reductions for products in the TEL and SL. Thus, all that this recommendation involves is uniformity in the provision of tariff reductions to all trading partners, and no change in time frame of liberalization schedules or the range of products covered.

b. Multilateralism Even Without Open Regionalism?

100. Adoption of the nondiscriminatory approach to regionalism by the new member countries would maximize the extent and pace of their integration with the global economy. They could avoid trade diversion, as well as trade, production, and investment deflection. The new members could also do away with the tedious and costly tasks of implementing rules of origin and measuring domestic content of their imports. This would be the first-best option.

101. But a myriad of political economy considerations often stands in the way of first-best economic solutions. As economist Paul Krugman puts it, preferential trading arrangements may have to be accepted "more or less grudgingly, as the best option in an age of diminished expectations." This view may derive from the fact that the first-best option of nondiscriminatory trade liberalization may not always be politically feasible, or at least not immediately feasible, and that the second-best option is to liberalize trade within regional blocks. Considering, the question is whether the pursuit of discriminatory regionalism necessarily implies that multilateralism will be impaired. This need not be so for the GMS economies in AFTA. Even if they chose not to multilateralize their preferences, regionalism can work in other ways as a vehicle to promote closer integration with the rest of the world. Even as a second-best option, regionalism through AFTA can help in the pursuit of multilateralism.

102. One avenue through which regionalism can promote multilateralism is through the strong links that the original ASEAN countries have with industrialized nations. Regional integration is bringing globalization to the doorstep of the Mekong through these links. Increasing integration with the original ASEAN countries will provide the GMS economies with a conduit to the outside world. Because the original ASEAN members conduct most of their trade extra-regionally, and receive most of their FDI from non-ASEAN members, they have long established links with the major industrialized countries. By integrating more closely with the original ASEAN members, the GMS economies will increase their opportunities for trade and investment with the rest of the world.

103. Indeed, the objective of establishing the ASEAN Economic Community (AEC) by 2020, a decision made at the 2003 Bali Summit, is to present the region to the global community as a single market and production base, with free flow of goods and services, and relatively free flows of capital and labor, throughout the grouping of 530 million people. The GMS economies will be part of, and should be in a position to take advantage of, this single market and production base. In the agreement that lays the foundation for AEC's establishment, ASEAN gave priority to the integrating of 11 industry sectors: wood, rubber, automotive, textiles, electronics, agriculture, information technology, fisheries, health care, air travel, and tourism. Many of these sectors are important to the GMS economies.[11]

104. The strategic location of the GMS region also provides opportunities for integration beyond the region. Location between the burgeoning economies of India and PRC presents a number of opportunities. The potential to boost trade, tourism, and investment is significant. Recognizing this potential, ASEAN leaders again confirmed their commitment to regionalism as a means to an end by signing framework agreements on comprehensive economic cooperation with both PRC and India. These agreements, signed at the Bali summit in October 2003, will create free trade areas between ASEAN and these countries.

[11] By being part of ASEAN, the GMS countries are also technically part of the ASEAN+3 arrangement, where the "3" are PRC, Japan, and the Republic of Korea. But so far, ASEAN+3 activities have focused on the original ASEAN members and have not yet included the new ASEAN members in a significant way. More information on ASEAN+3 activities is at http://aric.adb.org.

105. For PRC, reciprocal tariff reductions with Thailand (because it is an original ASEAN country) will begin in 2005, and will conclude by 2010. For the other GMS economies, liberalization begins in 2005, and is to be completed by 2015. With a view to accelerating implementation of the agreement with PRC, the parties involved also agreed to an Early Harvest Programme (EHP), to fast-track liberalization of trade in various agricultural products. This component will be particularly beneficial to the GMS economies since agriculture continues to constitute a significant share of their GDPs. The products covered by the EHP belong to chapters 01–08 of the 8\9 digit harmonized system, and relate mainly to live animals, fish, meat and dairy products, vegetables, fruits, and nuts.

106. The agreement with India includes different timelines for tariff reductions for original and new ASEAN members. India will reduce tariffs on exports of the new ASEAN members, as well as the Philippines, beginning in 2006 and ending in 2011. The new members will reciprocate by reducing tariffs on imports from India beginning in 2006 and ending in 2016. For trade between India and Thailand, the time frame for reciprocal tariff reductions is 2006 to 2011.

107. Closer integration with the burgeoning economy of PRC in particular, but also with that of India, is widely acknowledged not only to present opportunities but also to create challenges. PRC and India have large reserve pools of labor and thus have cost advantages in labor-intensive activities. With the scheduled 2005 end of the Multi-Fiber Agreement (MFA), both countries may be in a position to increase exports of textiles and clothing. Some of this could be at the expense of GMS economies. Although preferential access for some GMS economies to industrialized markets is expected to be retained through bilateral arrangements in the post-MFA period, the precise nature of these agreements has yet to be finalized. Even with these bilateral agreements, the GMS economies must eventually face the reality that the world trading environment is changing in such a way that preferential treatment must eventually give way to comparative advantage. The challenge that this poses for GMS is, once again, to become more economically diversified over time, and to restructure production to focus on activities in which they have a comparative cost advantage. The best trade policy environment to encourage specialization based on comparative advantage is one based on multilateralism.

D. Multilateralism

108. Some GMS economies are pursing globalization directly and independently through WTO membership, while others seek to join WTO. Thailand and Myanmar have been members for some time, and Cambodia joined WTO in September 2003. The other GMS economies are aggressively seeking membership.

109. It is worth noting however, that WTO membership now will have less impact on Lao PDR and Viet Nam than it might have had prior to AFTA. Lao PDR conducts most of its trade with other ASEAN countries, so it already receives MFN and National Treatment (NT) in these countries as a result of AFTA membership. Lao PDR already receives preferential treatment in many non-ASEAN trading partners. WTO membership will not affect that. The only exception is in to trade with the US, but current indications are that granting of Normal Trade Relations (NTR) status may well supersede Lao PDR's accession to the WTO.[12] The signing of the US-Lao PDR Bilateral Trade Agreement (BTA) in September 2003 is a sign of progress toward NTR status. The BTA is necessary for the implementation of normal trade status between the two countries, but will not go into effect until the US Congress enacts legislation authorizing NTR.

[12] In fact, it is unlikely that Lao PDR could proceed with WTO accession without first resolving the NTR issue.

110. Viet Nam has a comprehensive and wide-ranging bilateral trade agreement with the US, and recently signed a trade and investment agreement with Japan that solidifies MFN and NT for its trade and investment. The bilateral trade agreement with the US involves various commitments that will not only complement its push for WTO membership, but will also fast track many of the benefits of WTO membership, currently aimed fort 2005. In other words, the reform measures that Viet Nam is now implementing for the US bilateral agreement, and the benefits that accrue from these measures plus the concessions that the US provides, will lessen the net impact of WTO accession.

111. But this is a good thing; it reaffirms the complementarities between regionalism and multilateralism. Perhaps the best illustration of this point is a comparison with the PRC's accession to WTO. The benefits of PRC accession to WTO are expected to be substantial, mainly because PRC has long remained relatively closed and isolated from the global community. But unlike the PRC, years of liberalization and opening up associated with participation in subregional and regional initiatives means that a significant portion of the benefits have already accrued to countries like Viet Nam and Lao PDR. Thus, the benefits of their WTO membership at this stage will be only incremental.

112. Considering this, the most significant benefit to Lao PDR and Viet Nam from WTO membership may well be its demonstration effect. WTO membership will signal to the rest of the trading world that these countries were able to satisfy a demanding set of international trade and investment rules and guidelines. The returns from strong demonstration effects should not be underestimated, because they can have a significant impact on forging new trading relationships and attracting FDI.

VI. EXTERNAL DEBT BURDEN AND SUSTAINABILITY

A. Introduction

113. As transitional economies, the CLV countries[13] require substantial assistance and support from the international community and MFIs such as ADB to meet their development, social, and policy reform challenges. Achievement of the CLV countries' Millennium Development Goals will certainly require substantial external financing. But in trying to help these countries, it is important to avoid overburdening them with debt, or exceeding their absorptive capacities. Indeed, high debt itself can be an obstacle to growth, as argued in the vast debt overhang literature. The MFIs should carefully assess the issue of debt sustainability in formulating their lending and other programs. Are the current CLV debt levels sustainable, and can the CLVs continue to absorb additional lending?

114. Furthermore, transitional economies such as the CLVs typically rely on foreign capital to finance a chronic shortfall of domestic savings over investment, or the gap in their external current accounts. This itself is not problematic if the foreign funds are channeled, either directly or indirectly, into productive investments that enable the country to grow and generate future export earnings so it can repay its creditors. Thus, apart from the macroeconomic perspective of total debt burden and its sustainability, it is also important to look closely at individual projects in which MFIs invest, to ensure that their marginal contributions are to add to, rather than detract from, economic growth and development.

B. Cambodia

1. Debt Burden

115. Cambodia's estimated external debt is about $2.2 billion (Table A2.10). About 60% of this debt is owed to Russia and another 15%, to the US. These debts are not being serviced, and are subject to negotiation. Almost all of the remaining debt is on highly concessional terms. Discussions with Russian authorities in June and September 2002 resulted in an understanding on the broad terms for the pre-cutoff date debt, but further negotiations are required for the post-cutoff date debt. Although no agreement has been reached on Cambodia's debt to Russia, the 2000 resolution of this debt for Viet Nam and recent positive developments for Lao PDR suggest the possibility of a favorable and speedy resolution. On the US debt, a number of exchanges have occurred since April 2002 to determine the precise amount of the debt that might be written off, and the amount to be rescheduled. Negotiations are ongoing.

116. Putting aside the nonserviced debts owed to Russia and the US, Cambodia has a low and manageable external debt situation, in both stock and flow terms. The stock of external debt has remained relatively stable since 1999, with a nominal value of about $0.6 billion. As a share of GDP, the external debt is only about 16%, and the trend has been downward since 1999. In relation to the other 77 PRGF-eligible countries, this ratio would place Cambodia in the most favorable position with the lowest debt-to-GDP ratio. The debt-to-exports ratio has also fallen sharply since 1999, and is now less than 25%. This level is considered comfortable. Similarly, the ratio of debt to government revenue (excluding grants) has also been trending down.

[13] Although Myanmar is also a transitional economy and GMS member country, we have not included it in our analysis because of data constraints. At the end of 2000, Myanmar was estimated to have a $5.4 billion outstanding external medium- and long-term public debt.

2. Debt Service

117. While the debt stock has remained relatively unchanged over recent years, debt service has been dropping sharply (Table A2.11). The debt service ratio has fallen from about 18% in1998 to less than 3.5% in 2002. That level is comfortable, considering that only 3 of the 78 PRGF-eligible countries had lower debt service ratios than Cambodia. The low debt service ratio largely reflects the high share of concessional loans. The average interest on new commitments in 2001, for example, was only 0.9% (Table A2.12). World Bank projections suggest that debt service will fall to about 2% in 2004. The Asian financial crisis highlighted the significance of adequate foreign exchange reserves relative to debt service payments (the reserve coverage ratio). Reserve coverage has also increased over the years, and is currently healthy.

C. Lao PDR

1. Debt Burden

118. Lao PDR's total external debt is now about $3 billion, or slightly higher than 170% of GDP (Table A2.13). At face value, this appears to be a significant debt burden. But more than half of Lao PDR's total debt is with Russia, and is not being serviced. Lao PDR has long been negotiating with Russia on final disposition of this debt. In June 2003, the two governments agreed in principle to (i) write off 70% of the debt owed to the Russian Federation, and (ii) service the remaining debt of $380 million over a 33-year period at a preferential interest rate. This is consistent with the terms of Russia's memorandum of understanding as a creditor in the Paris Club. A specific agreement relating to the interest rate, grace period, flow rescheduling, and payment modalities (cash, goods, and\or investment) is still pending.

119. Of the remaining debt in convertible currency, less than 5% is commercial, and the rest is long-term concessionary with bilateral and multilateral donors. Counting only debt in convertible currency, the debt stock is less than the country's GDP, and has remained at or below 70% over the past few years. In nominal terms, this amount to about $1.2 billion or $700 million in net present value terms. For a transitional economy seeking rapid economic development, this ratio should appear neither surprising nor unwarranted, as long as borrowed resources are used productively. Compared with the other PRGF-eligible countries, this ratio would place Lao PDR in the bottom half. Before resolution of the Russian debt, Lao PDR ranked 14th highest of the 78 PRGF-eligible countries. Although the debt-to-exports ratio has stabilized in recent years, it remains high. The ratio of debt to government revenue has also declined, but at more than five times revenue it remains disturbingly high. Lao PDR has had long-standing problems with revenue collection. The country has recently instituted measures to address the problem, so hopefully the ratio will decline over time.

2. Debt Service

120. The debt stock may appear somewhat high, but various flow measures relating to debt servicing confirm that it remains manageable. The debt service ratio remains low at about 8% of the country's exports of goods and services (Table A2.14). Lao PDR's debt service ratio is within the 20% of countries with the lowest debt service ratio. The reserve coverage ratio also remains healthy, at about 5. None of the Russian debt was being serviced prior to the agreement reached in June 2003, so Lao PDR's debt servicing burden will probably increase slightly because a small portion of this debt soon must be serviced. The average interest on new commitments remains low, at 1.2% in 2001. An average grace period of almost 9 years will provide breathing space

(Table A2.15). If the Nam Theun 2 hydropower project and the OXIANA mine of the Lane Xang Mineral Co. begin to generate revenue, the debt service burden as a share of exports is likely to diminish considerably. If the project materializes, Nam Theun 2 is expected to generate about $30 million per year for 10 years, starting in 2009. Afterward, the revenues will increase sharply as the share going to the Government increases.

121. Lao PDR is officially classified as an HIPC (highly indebted poor country) when the Russian debt is included in its debt burden. The Government believes that Lao PDR is able to comfortably service its debt, and the country has not sought debt relief. The recent in-principle agreement reached on the Russian debt further reinforces this position. Even before the agreement, Lao PDR's inclusion in the HIPC list was borderline. Once the agreement is implemented, Lao PDR should no longer be classified an HIPC country.

D. Viet Nam

1. Debt Burden

122. Viet Nam is the only Mekong country that has successfully concluded negotiations with Russia to resolve its outstanding debt. Viet Nam's external debt position has improved since reaching the agreement with Russia in September 2000 in which Viet Nam secured a major write down of its outstanding nonconvertible debt dues. Viet Nam's stock of total external debt is currently about 40% of GDP, and its nominal value has remained less than $15 billion over the past 3 years (Table A2.16). Viet Nam is in the bottom fourth of PRGF-eligible countries in terms of debt-to-GDP ratio. The Russian government has agreed to discount its claims on Viet Nam by 70%. Of the remaining debt (valued at one transferable ruble per dollar), 50% will be written off, and the balance of $1.7 billion will be repaid over 23 years—10% in cash and 90% in goods. Ongoing negotiations with Russia could further reduce the debt stock. The profile of future debt servicing obligations shows a declining trend. The debt-to-exports ratio has also declined over recent years.

2. Debt Service

123. Viet Nam's debt service payment has remained stable at about $1.1 billion over the past 3 years (Table A2.17). With a stable debt service payment and strong growth in exports, it is not surprising that the debt service ratio has been declining since 1998, and is now only about 10% of goods and services exports. As with the debt-to-GDP ratio, Viet Nam's debt service ratio also falls in the bottom four compared with other PRGF-eligible countries. World Bank projections suggest that the debt service ratio will fall to 7.5% in 2003. The average interest on new commitments has declined steadily from 2.4% in 1998 to 1.0% in 2001 (Table A2.18). The reserve coverage ratio has also been increasing over the years, and has now surpassed 3.

124. Viet Nam's debt experience clearly highlights the vast improvement in its overall debt position following resolution of the Russian debt burden. Lessons for Cambodia and Lao PDR are obvious; once the Russian debt is resolved, the situation improves enough that the country no longer looks vulnerable in terms of stock or flow indicators of external debt. The Viet Nam experience suggests that debt vulnerability in much of the Mekong region has historical roots that can be traced back to the command economy that operated during the Soviet era. Resolving this debt overhang transforms the outlook for debt sustainability radically.

125. Another reflection of the Soviet era influence is the fact that Viet Nam had been classified as a HIPC based on historical data. But even before resolution of the Russian debt,

analysis of debt sustainability based on medium- to long-term projections by the World Bank and IMF in1996 indicated that Viet Nam's debt burden was sustainable. This status has not changed since then. On this basis, Viet Nam has not been eligible for debt relief through the HIPC initiative. Recent trends indicating improvement in Viet Nam's external debt situation, in addition to resolution of the Russian debt, reinforce the position that Viet Nam will not get debt relief under the Initiative. Viet Nam has now graduated from being classified as a severely indebted to a moderately indebted country under the World Bank Debtor Classification System.

E. Looking Forward

126. A question that must be asked is whether current and future borrowings of the CLV countries is likely to result in a repeat of the debt problems associated with the Russian debt? In other words, is history likely to repeat itself in these countries, and are MFIs like ADB playing a role in reinventing these problems? This is unlikely for several reasons. First, the nature and structure of the CLV countries' economies today differ from their economies when the Russian debt was accumulating. The CLV countries have come a long way since in moving toward a market economy, and in adopting and instituting market-based mechanisms and principles. Many current or rapidly emerging checks and balances were absent during the command economy period. Also, legal, bureaucratic, and administrative systems have been evolving to ensure that borrowings and investments are secure and put to productive use. Rather than adding to economic vulnerability, recent and current borrowings are helping reduce it, and contributing to economic growth and development by improving basic infrastructure, enhancing productivity, reforming institutions and policies, and contributing to human development. By promoting private sector development in particular, MFIs such as ADB are actually working toward reducing the governments' reliance on foreign borrowings and thus, curtailing the buildup of future debt.

VII. SUMMARY AND CONCLUSIONS

127. The GMS is one of the world's fastest-growing subregions. With the exception of Thailand, which was directly affected by the Asian financial crisis, growth has remained about 4% or higher in all of the GMS economies for the past decade. Growth has accelerated in most GMS economies over the past few years, and appears to have ranged from 5% to 7% in 2003. By any standard, this record of economic growth is remarkable.

128. The CLMV countries of the GMS are currently undergoing multiple transitions, which present both challenges and opportunities. The future of GMS will largely depend on how successfully the CLMV countries manage these transitions.

129. The first important transition is the changing role that the state and markets play. Acceptance is growing that markets and the private sector can do many things better than government. Consequently, the private sector's contribution to total economic activity has been growing faster than that of the state sector in most GMS economies.

130. A second important transition is that the structure of most GMS economies is diversifying. Subsistence agriculture is giving way to commercial agriculture, and the share of agriculture in total income is beginning to fall as emerging manufacturing activities, including agro-processing, expand. This pattern of diversification is both a cause and a consequence of rising income levels and greater prosperity.

131. Social changes will also affect economic conditions in GMS. Over the next two decades a bulge will occur in the size of the population of working age. Low-productive, subsistence agriculture will not be able to fully absorb new entrants to the labor force in the future. Although economies are already diversifying, much of the diversification is a natural process associated with economic growth. Unless specific interventions complement this natural diversification process, it is doubtful that a large rise in unemployment can be avoided in the future.

132. Finally, and related to the development of markets, the GMS economies are becoming more "open" economically. Informal cross-border trade has always been important. Now, formal trade and investment flows are also flourishing.

133. Although many of these transitions are direct or indirect results of reform programs, overcoming the challenges that they pose or fully realizing the opportunities they present is in no sense preordained. Much will depend on choices that are made going forward, and how policy makers address the challenges they face, both individually and collectively. The different modalities of economic cooperation in which the economies of the GMS are involved will play an important role in overcoming these challenges and taking the region forward.

134. Economic cooperation and integration is taking place at three levels: subregional, regional, and multilateral.

135. At the subregional level, ADB's GMS program plays a catalytic role in promoting trade and spreading development benefits throughout GMS. Although its main thrust has been on developing essential infrastructure, the GMS program has also supported a range of measures to facilitate trade and investment that are designed to promote integration. The impact of these interventions is already being reflected in recorded trade and investment statistics for the subregion, with early signs of an emerging virtuous trade-investment nexus.

136. The GMS program is a classic case of *market* as opposed to *institutional* integration. Institutional integration is characterized by legal agreements and institutional arrangements that promote preferential trade among members of the agreement, while market integration relies on nonofficial institutions that provide regional public goods that reduce transaction costs associated with the international movement of goods, services, and other production factors.

137. As a result of this, subregionalism is driving regionalism and multilateralism through positive spillover effects. The benefits that accrue from improved infrastructure or from measures to facilitate trade and investment are not confined to the subregion. Countries outside the subregion will also have access to the benefits, either directly or indirectly, and thus will contribute to increased trade and investment on a more general level.

138. At the regional level, ASEAN and AFTA are driving trade liberalization and the opening of markets. Tariffs have already fallen sharply for a wide range of commodities as a result of meeting AFTA commitments, and AISP is accelerating the integration of the CLMV countries into the regional market.

139. Regionalism through ASEAN membership also provides the Mekong economies with an opportunity to pursue multilateralism aggressively. If the new member countries emulate the original ASEAN members and adopt the nondiscriminatory approach to regionalism, the extent and pace of their integration with the global economy will be maximized. They will be able to avoid trade diversion, as well as trade, production, and investment deflection. New member countries could also do away with the tedious and costly tasks of implementing rules of origin and measuring domestic content of their imports. This would be the first-best option.

140. But a myriad of political economy considerations may stand in the way of this first-best option. In light of this, the question is: Will the pursuit of discriminatory regionalism necessarily imply impairment of multilateralism? This need not be so for the GMS economies in AFTA. Even if the GMS economies choose not to multilateralize their preferences, regionalism can work in other ways as a vehicle to promote closer integration with the rest of the world.

141. This can happen in a number of ways. Through the original ASEAN countries' strong links with the industrialized nations, regional integration is bringing globalization to the doorstep of GMS. The strategic location of GMS also provides opportunities for integration beyond the region. Being between the burgeoning economies of India and PRC, gives significant potential to boost trade, tourism, and investments. The recent signing of agreements to create free trade areas between ASEAN and these economies significantly increases the potential to exploit these opportunities. The agreement also highlights how regionalism promotes multilateralism by extending integration beyond the region's boundaries.

142. Some GMS economies are pursing globalization independently through WTO membership, while others are seeking membership. Thailand and Myanmar have been members for some time, and Cambodia joined in September 2003. The other GMS economies are aggressively pursuing membership. Because Lao PDR and Viet Nam have come a long way in their liberalization efforts through active participation in initiatives for subregional and regional cooperation, the most significant benefit accruing from WTO membership may well be through demonstration effects. WTO membership will signal to the rest of the trading world that these economies have successfully satisfied a demanding set of international trade and investment rules and guidelines.

143. Finally, the MREO analyzed the external debt burden sustainability in the CLV countries. Debt vulnerability in the CLV countries largely appears to be a legacy of their past. Its historical roots can be traced back to the command economies of the Soviet era. A common feature in the debt composition in Lao PDR, Viet Nam, and Cambodia is the significant share owed to the Russian Federation. More than half the debt stock in these countries has historically been Russian debt. All three countries have been negotiating with Russia on final disposition of this debt.

144. A significant breakthrough was in September 2000, when Viet Nam and the Russian Federation reached agreement to write off most of the Russian debt, with the remainder serviced on highly concessional terms. This eventually led to a similar in principle agreement between Lao PDR and Russia in June 2003. Although agreement on resolving Cambodia's debt to Russia is still pending, the Viet Nam breakthrough and the recent follow-through for Lao PDR gives hope for a speedy resolution under similarly favorable terms.

145. Viet Nam's experience suggests that once the Russian debt is resolved favorably, the situation improves to such an extent that the country no longer looks vulnerable in terms of any of the stock or flow indicators of external debt. It is also unlikely that these countries will face a debt overhang problem again, like with the Russian debt. The move toward a market-based economy, and the institutions that have emerged since the Russian debt was accumulated, are safeguards against a repeat of such debt problems.

146. Considering the Viet Nam experience, it is reasonable to conclude that the debt situation in these Mekong economies will be considered sustainable if the Russian debt is resolved favorably. Even with the Russian debt on the books, the debt situation could still be considered sustainable, because the debt is not being serviced. So either way, one can conclude that these economies are in a position to continue to absorb more lending, particularly if on concessional terms, and if it leads to improved productivity, policy reform, and revenue generation in excess of servicing costs. Indeed, as transitional economies, further inflows of aid and loans will be essential to assist in economic development. By promoting private sector development in particular, MFIs such as ADB actually work toward reducing the governments' reliance on foreign borrowings, and thus curtail the buildup of future debt obligations.

TARIFF REVENUE AND SMUGGLING

1. The smuggling of nonprohibited goods is driven mainly by economic considerations. Reducing or removing tariffs and other barriers to trade is likely to take away much of the incentive to engage in informal trade, or smuggling. In this Appendix, we describe the conditions under which this would occur, and identify the impact on revenue collection. If the lowest-cost supplier is from outside the Association of Southeast Asian Nations (ASEAN) region, then nondiscriminatory, multilateral reduction of tariffs will further reduce the incentive to smuggle. In other words, the magnitude of the tariff reduction required to remove the incentive to smuggle will be lower if the lowest-cost supplier is non-ASEAN, and the liberalization is multilateral. In the presence of tariffs and other barriers to trade,[1] smuggling will occur if

$$s < t(1) \qquad (1)$$
$$\text{i.e., } p\,(1+s) < p\,(1+t(1)). \qquad (1a),$$

where p is the marginal cost of the import, $t(1)$ is the pre-reform tariff rate plus the tariff equivalent of non-tariff and other barriers to trade (measured as a fraction of p), and s is the "smuggling premium" (i.e. the payment that the syndicate extracts for the smuggling activity, also measured as a fraction of p).[2]

2. If tariff and other barriers are reduced to $t(2)$ such that

$$s > t(2), \qquad (2),$$

then the incentive to smuggle is removed. Smuggling ceases because it is now cheaper for the importer to pay the new tariff-inclusive price than the smuggling premium-inclusive price,

$$\text{i.e., } p\,(1+s) > p\,(1+t(2)). \qquad (3).$$

3. Implications for revenue collection are important if the import were smuggled in the pre-reform period because of the magnitude of the tariff (i.e. $t(1) > s$), but smuggling ceased when the tariff was reduced (i.e. $t(2) < s$). First, as long as the new tariff is greater than zero (i.e. $t(2) > 0$), tariff revenue collections will increase because no tariff revenue was collected on the smuggled good. Tariff revenues could increase by even more under nondiscriminatory liberalization if the lowest-cost supplier were from outside ASEAN because the tariff reduction required to satisfy equation 2 would be lower. Second, we can see from equation (3) that the price of the import in the domestic market will fall, relative to the smuggling premium-inclusive price. The price reduction associated with the switch out of smuggling will increase the volume of the import, *ceteris paribus*. This will further increase total tariff revenue collections.[3]

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[1] Apart from tariffs, other barriers to trade include factors such as various technical non-tariff barriers, excessive red tape, problems with transport at borders. It is reasonable to assume that these other barriers apply equally to intra-, as opposed to extra-ASEAN imports.

[2] We assume that the costs to the smuggler associated with organizing the import of the good through illegal channels is less than the benefit, (p. s).

[3] Apart from the potential to increase tariff revenue collections, the reduction in smuggling has at least two other effects. First, the share of recorded trade in total (recorded plus unrecorded) trade will increase, thus improving the reliability of trade data. Second, the informal market for finance, which is the monetary dual to the informal trade problem, will likely diminish in significance, thus improving the ability of monetary authorities to conduct monetary policy. Reducing the informal market for finance as a result of reduced smuggling also implies an overall improvement in a country's governance climate.

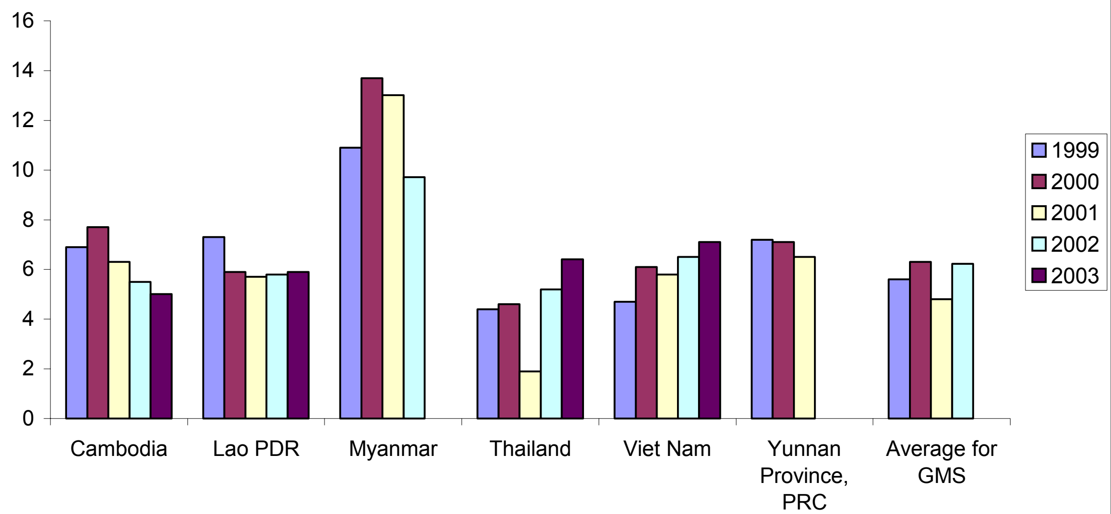
ECONOMIC AND SOCIAL INDICATORS

Table A2.1: GDP Growth, 1999–2003
(%)

Country	1999	2000	2001	2002	2003
Cambodia	6.9	7.7	6.3	5.5	5.0
Lao PDR	7.3	5.9	5.7	5.8	5.9
Myanmar	10.9	13.7	13.0[a]	9.7[a]	—
Thailand	4.4	4.6	1.9	5.2	6.4
Viet Nam	4.7	6.1	5.8	6.5	7.1
Yunnan Province, PRC	7.2	7.1	6.5	—	—
Average for GMS[b]	5.6	6.3	4.8	6.2[c]	—

— = not available.
GDP = gross domestic product, GMS = Greater Mekong Subregion, Lao PDR = Lao People's Democratic Republic, PPP = purchasing power parity, PRC = People's Republic of China.
[a] Source: Ministry of National Planning and Economic Development Statistical Yearbook, various issues.
[b] Weighted average based on PPP gross national income shares.
[c] Weighted average does not include Yunnan Province, PRC, in 2002 because data are not yet available.
Sources: Asian Development Bank. *Key Indicators*. Manila; Bank of Lao PDR; General Statistics Office, Viet Nam; International Monetary Fund; Ministry of Finance, Lao PDR; Ministry of Economy and Finance, Cambodia; National Bank of Cambodia; National Bureau of Statistics of China. *China Statistical Yearbook*. National Economic and Social Development Board, Thailand; National Institute of Statistics, Cambodia; National Statistical Center, Lao PDR; State Bank of Viet Nam; Asian Development Bank estimates.

Figure A2.1: GDP Growth, 1999–2003, %



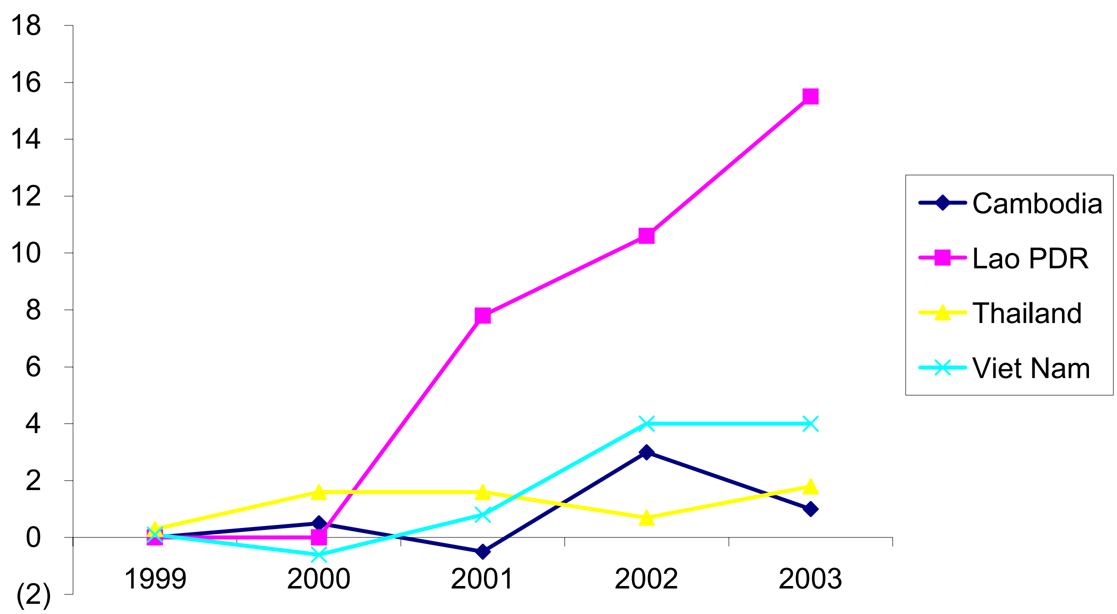
GDP = gross domestic product, GMS = Greater Mekong Subregion, Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China

Table A2.2: Inflation Rate (Consumer Price Index)
1999–2003, (%)

Country	1999	2000	2001	2002	2003
Cambodia [a]	—	0.5	(0.5)	3.0	1.0
Lao PDR	134.0	27.1	7.8	10.6	15.5
Myanmar	18.4	(0.1)	21.1	57.1	—
Thailand	0.3	1.6	1.6	0.7	1.8
Viet Nam	0.1	(0.6)	0.8	4.0	4.0

— = not available.
Lao PDR = Lao People's Democratic Republic.
[a] Final quarter of the year.
Sources: Bank of Lao PDR; General Statistics Office, Viet Nam; International Monetary Fund; Ministry of Finance, Lao PDR; Ministry of Economy and Finance, Cambodia; National Bank of Cambodia; National Economic and Social Development Board, Thailand; National Institute of Statistics, Cambodia; National Statistical Center, Lao PDR; State Bank of Viet Nam; Asian Development Bank estimates.

Figure A2.2: Inflation Rate (Consumer Price Index)[a]
1999-2003, %



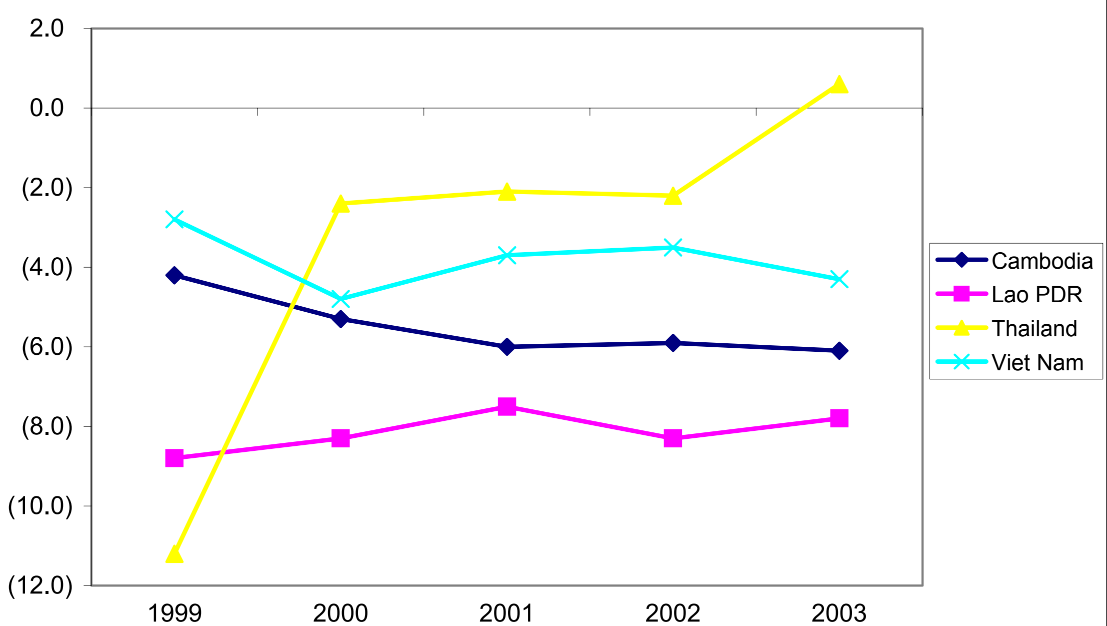
[a] We have excluded the data for Myanmar and data for 1999-2000 for Lao PDR from the above chart (but not the above table) to avoid problems with scaling.

Table A2.3: Fiscal Balance/GDP [a]
1999–2003, (%)

Country	1999	2000	2001	2002	2003
Cambodia [a]	(4.2)	(5.3)	(6.0)	(5.9)	(6.1)
Lao PDR [a]	(8.8)	(8.3)	(7.5)	(8.3)	(7.8)
Myanmar	(0.2)	0.7	—	—	—
Thailand [b]	(11.2)	(2.4)	(2.1)	(2.2)	0.6
Viet Nam	(2.8)	(4.8)	(3.7)	(3.5)	(4.3)

— = not available.
GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic.
[a] Excluding grants.
[b] Includes national government's budgetary and nonbudgetary accounts.
Sources: Bank of Lao PDR; General Statistics Office, Viet Nam; International Monetary Fund; Ministry of Finance, Lao PDR; Ministry of Economy and Finance, Cambodia; National Bank of Cambodia; National Economic and Social Development Board, Thailand; National Institute of Statistics, Cambodia; National Statistical Center, Lao PDR; State Bank of Viet Nam; Asian Development Bank estimates.

Fiscal Balance/GDP[a]
1999-2003, %



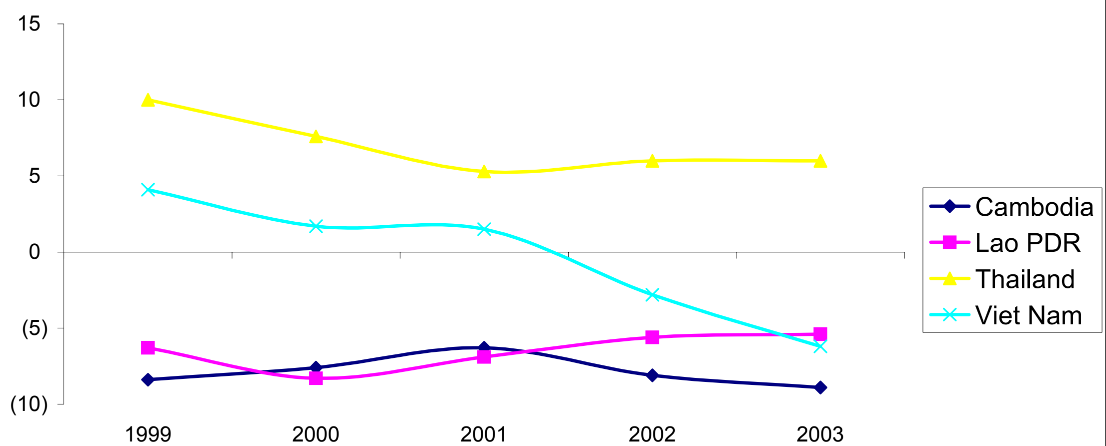
GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic.
[a] Myanmar is excluded from the above chart due to sparsity of data.

Table A2.4: Current Account Balance/GDP[a]
1999–2003, (%)

Country	1999	2000	2001	2002	2003
Cambodia	(8.4)	(7.6)	(6.3)	(8.1)	(8.9)
Lao PDR	(6.3)	(8.3)	(6.9)	(5.6)	(5.4)
Thailand	10.0	7.6	5.3	6.0	6.0
Viet Nam	4.1	1.7	1.5	(2.8)	(6.2)

GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic.
[a] Excluding official transfers.
Sources: Bank of Lao PDR; General Statistics Office, Viet Nam; International Monetary Fund; Ministry of Finance, Lao PDR; Ministry of Economy and Finance, Cambodia; National Bank of Cambodia; National Economic and Social Development Board, Thailand; National Institute of Statistics, Cambodia; National Statistical Center, Lao PDR; State Bank of Viet Nam; Asian Development Bank estimates.

Figure A2.4: Current Account Balance/GDP
1999-2003, %



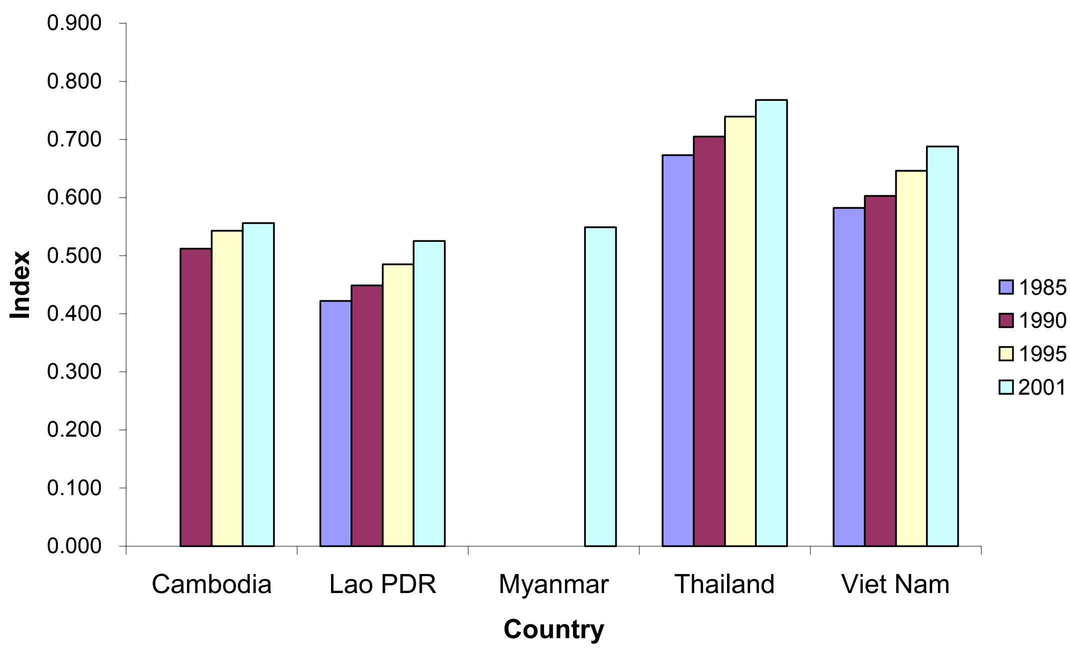
GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic

Table A2.5: Human Development Index, 1985–2001

Country	1985	1990	1995	2001
Cambodia	—	0.512	0.543	0.556
Lao PDR	0.422	0.449	0.485	0.525
Myanmar	—	—	—	0.549
Thailand	0.673	0.705	0.739	0.768
Viet Nam	0.582	0.603	0.646	0.688

— = not available.
Lao PDR = Lao People's Democratic Republic.
Source: United Nations Development Programme. (Various issues). *Human Development Report*, New York).

Figure A2.5: Trend of HDI, 1985-2001



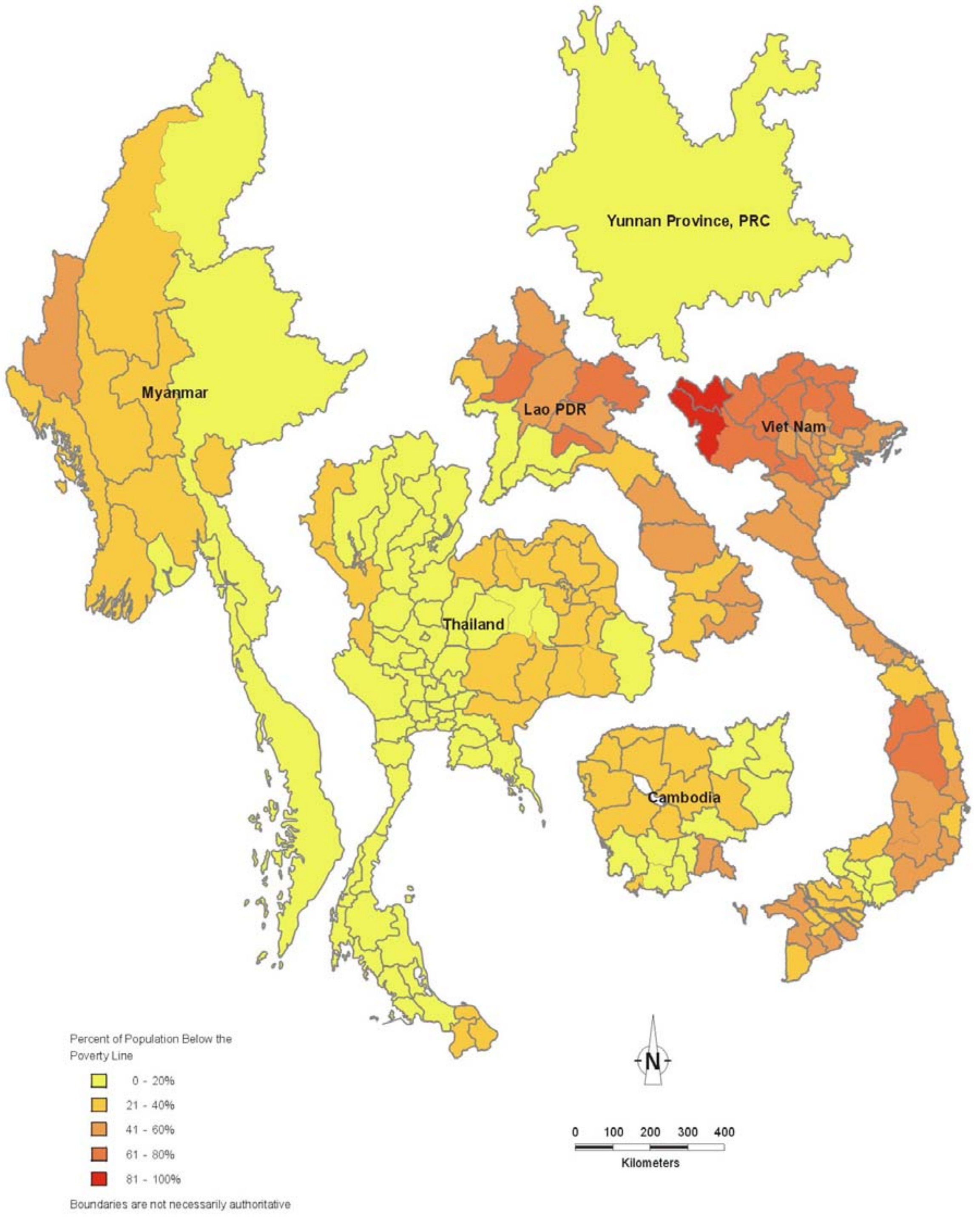
HDI = human development index, Lao PDR = Lao People's Democratic Republic
Source: Human Development Report, United Nations Development Programme, various issues.

Table A2.6: Population Below the National Poverty Line in Urban and Rural Areas (%)

Country	1993 (1994)		1997 (1996)		Latest Figure	
	Urban	Rural	Urban	Rural	Urban	Rural
Cambodia	—	—	21.1	40.1	25.2 [b]	40.0 [b]
Lao PDR	24.1 [a]	53.0	26.9	41.0	—	—
Myanmar	—	—	23.9	22.4	—	—
Thailand	10.2	13.1	—	—	1.5 [c]	17.2 [c]
Viet Nam	25.9	57.2	—	—	6.6 [d]	36.0 [d]

— = not available.
Lao PDR = Lao People's Democratic Republic.
[a] 1994 figure.
[b] 1999 figure.
[c] 2000 figure.
[d] 2002 figure.
Source: Country yearbook and websites; and ASEAN in Figures 2003.

Figure A2.6: Distribution of Poverty in GMS Countries



GMS = Greater Mekong Subregion, Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China
Source: ADB, Greater Mekong Subregion Atlas of the Environment, 2004.

Table A2.7: Human Development Indicators

Country	Life Expectancy at Birth (Years) 2001	Adult Literacy Rate (%) 2001[a]	Gross Enrolment Ratio (%) 2000–2001[b]	Life Expectancy Index	Education Index
Cambodia	57.4	68.7	55.0	0.54	0.64
Lao PDR	53.9	65.6	57.0	0.48	0.63
Myanmar	57.0	85.0	47.0	0.53	0.72
Thailand	68.9	95.7	72.0 [c]	0.73	0.88
Viet Nam	68.6	92.7	64.0	0.73	0.83

Lao PDR = Lao People's Democratic Republic.
[a] Age 15 and above.
[b] Combined primary, secondary, and tertiary.
[c] Preliminary United Nations Educational, Scientific and Cultural Organization. Institute for Statistics estimate, subject to further revision.
Source: United Nations Development Programme. *Human Development Report* New York (various issues).

Table A2.8: Openness Ratios [a]
(% of GDP)

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Cambodia	30.0	30.4	45.0	60.3	49.9	58.0	64.3	72.7	92.6	96.3	101.8
Lao PDR	29.8	44.6	46.0	43.2	47.5	44.0	62.5	51.3	45.3	43.2	40.9
Myanmar[b]	3.6	3.4	2.9	2.5	2.2	1.9	1.5	1.2	1.1	1.0	—
Thailand	61.3	61.7	64.2	70.9	65.1	74.2	80.0	81.2	101.2	102.1	98.1
Viet Nam	50.8	49.4	57.1	61.4	70.1	73.1	72.4	77.1	91.5	90.5	103.9
Yunnan Province, PRC	9.1	8.7	14.9	16.0	12.3	8.2	7.3	7.7	8.0	8.6	—
Average for GMS[c]	48.0	48.1	52.3	57.7	54.8	59.8	61.2	62.6	76.3	75.8	99.0[d]

— = not available, GMS = Greater Mekong Subregion, GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.
[a] Defined as the ratio of total trade to GDP at current market price. For most countries, exports and imports in US dollar terms were taken from the BOP statistics, and converted to local currency using the average nominal exchange rate.
[b] Ratio of total trade in kyats (local currency) to GDP at current market price.
[c] Weighted average based on PPP Gross National Income shares.
[d] Weighted average does not include the figures for Myanmar and Yunnan Province, which are not yet available.
Sources: Asian Development Bank. *Key Indicators*. Manila; and National Bureau of Statistics of China

Table A2.9: Share of Intraregional Trade to Total Trade [a]
(%)

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Cambodia	20.1	34.5	39.0	36.4	33.6	40.0	31.5	22.0	19.5	27.3	24.5
Lao PDR	63.3	48.9	55.8	57.3	61.1	66.8	65.7	70.6	65.5	68.6	67.8
Myanmar	23.4	23.6	22.8	24.1	18.1	17.5	18.5	27.6	28.9	34.0	35.6
Thailand	2.8	2.5	3.4	4.0	4.0	4.6	5.3	6.0	6.8	7.7	8.9
Viet Nam	4.7	8.0	9.9	10.4	7.9	8.9	10.9	11.9	14.9	14.6	13.9
Yunnan Province, PRC [b]	1.2	1.2	1.3	1.9	1.7	1.8	1.7	1.7	2.1	2.1	1.9
Average for GMS[c]	5.7	6.2	7.2	7.6	6.7	7.4	8.3	9.5	10.7	12.0	12.6

GMS = Greater Mekong Subregion, Lao PDR = Lao People's Democratic Republic. PPP = purchasing power parity, PRC = People's Republic of China.
[a] Ratio of total trade with GMS countries (total trade with entire PRC was used) to total trade with the world.
[b] Ratio of total trade of the entire PRC with the other GMS countries to total trade of the entire PRC with the world.
[c] Weighted average based on PPP Gross National Income shares.
Source: International Monetary Fund. *Direction of Trade Statistics.* Washington DC.

Table A2.10: Cambodia: External Debt Indicators
(Stock Measures)

Item	1998	1999	2000	2001	2002
Total External Debt[a] ($ billion)	2.11	2.27	2.26	2.25	2.25
Total Convertible Currency External debt[b] ($ billion)	0.35	0.60	0.60	0.59	0.59
Total Convertible Currency External Debt/ GDP (%)	11.70	18.50	17.60	16.80	15.70
Total Convertible Currency External Debt/ Exports (%)	33.60	44.60	31.60	29.50	24.90
Total Convertible Currency External Debt/ Government Revenue (%)	140.00	173.40	163.50	139.80	—

— = not available, GDP = gross domestic product.
[a] This amount excludes the debts owing to Russia and the United States.
[b] Total convertible currency external debt is defined here to exclude debts owing to Russia and the United States.

Table A2.11: Cambodia: Debt Service (Flow Measures)

Item	1998	1999	2000	2001	2002
Debt Service Payment ($ million)	9.6	28.6	23.4	8.5	—
Of which					
Principal Repayments on Long-Term Debt ($ million)	4.2	15.0	6.9	0.9	—
Interest on Long-Term Debt ($ million)	3.7	11.9	11.9	4.5	—
Interest on Short-Term Debt ($ million)	1.7	1.7	4.6	3.1	—
Reserve Coverage [a]	32.8	13.6	21.4	69.0	—
External Debt Service [b] (%)	17.9	14.2	10.1	3.8	3.4

[a] Foreign exchange reserves divided by debt service payment.
[b] Debt service payment as a percentage of exports of goods and services.

Table A.12: Cambodia: Average Terms of New Commitments

Item	1998	1999	2000	2001
Interest (% p.a.)	0.5	1.1	1.3	0.9
Maturity (years)	39.5	37.6	30.3	34.5
Grace Period (years)	10.0	9.7	8.2	9.9
Grant Element (%)	82.5	76.2	68.6	76.8

p.a. = per annum.

Table A2.13: Lao PDR: External Debt Indicators (Stock Measures)

Item	1998	1999	2000	2001	2002
Total External Debt [a] ($ billion)	3.5	2.8	2.7	2.8	3.0
Total Convertible Currency External Debt [b] ($ billion)	1.7	1.1	1.1	1.2	1.2
Total Convertible Currency External Debt/GDP (%)	101.3	73.4	64.4	68.2	70.0
Total Convertible Currency External Debt/Exports (%)	361.7	241.0	214.4	249.5	240.2
Total Convertible Currency External Debt/Government Revenue (%)	1,491.0	846.2	509.3	542.1	—

— = not available
[a] This amount excludes the debt owing to Russia.
[b] Total convertible currency external debt is defined here to exclude debt owing to Russia.

Table A2.14: Lao PDR—Debt Service (Flow Measures)

Item	1998	1999	2000	2001	2002
Debt Service Payment ($ million)	24.2	28.6	32.6	34.0	36.3
of which					
Principal Repayments on Long-Term Debt ($ million)	16.4	19.5	22.9	24.1	25.6
Interest on Long-Term Debt ($ million)	7.6	9.0	9.4	9.8	10.7
Interest on Short-Term Debt ($ million)	0.2	0.1	0.3	0.1	—
Reserve Coverage [a]	4.4	3.5	4.3	3.8	5.1
External Debt Service [b] (%)	4.6	6.3	5.7	7.2	8.0

— = not available.
[a] Foreign exchange reserves divided by debt service payment.
[b] Debt service payment as a percentage of exports of goods and services.

Table A2.15: Lao PDR: Average Terms of New Commitments

Item	1998	1999	2000	2001
Interest (% p.a.)	1.7	1.2	1.4	1.2
Maturity (years)	39.4	33.8	31.6	32.9
Grace Period (years)	9.9	8.7	8.1	8.8
Grant Element (%)	71.7	72.8	69.9	72.4

Lao PDR = Lao People's Democratic Republic, p.a. = per annum.

Table A2.16: Viet Nam: External Debt Indicators (Stock Measures)

Item	1998	1999	2000	2001	2002
Total External Debt ($ billion)	20.5	20.3	11.9	13.0	14.1
Total External Debt/GDP (%)	76.5	72.1	38.7	40.9	41.6
Total External Debt/ Exports (%)	219.0	176.5	82.2	86.7	84.4

GDP = gross domestic product.

Table A2.17: Viet Nam: Debt Service (Flow Measures)

Item	1998	1999	2000	2001	2002
Debt Service Payment ($ million)	910.0	1,380.0	1,279.0	1,171.0	1,108.0
of which					
Principal Repayments on Long-Term Debt ($ million)	587.0	1,021.0	932.0	789.0	824.0
Interest on Long-Term Debt ($ million)	387.0	326.0	296.0	354.0	284.0
Interest on Short-Term Debt ($ million)	36.0	33.0	51.0	28.0	—
Reserve Coverage [a]	2.2	2.4	2.7	3.1	—
External Debt Service [b] (%)	13.9	12.8	10.5	10.6	10.2

— = not available.
[a] Foreign exchange reserves divided by debt service payment.
[b] Debt service payment as a percentage of exports of goods and services.

Table A2.18: Viet Nam: Average Terms of New Commitments

Item	1998	1999	2000	2001
Interest (% p.a.)	2.4	2.3	1.4	1.0
Maturity (years)	29.1	34.0	36.1	38.8
Grace Period (years)	8.2	9.1	9.6	9.8
Grant Element (%)	59.5	63.9	73.2	77.3

p.a. = per annum.