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

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[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.