

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 pursuing 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.