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# From Cross-Border Trade to Regional Integration?

## Dr. K.A.S. Murshid Provides an Overview of the Cross-Border Economies of Cambodia, Laos, Vietnam and Thailand *

The Development Analysis Network (DAN) is a network of research institutes from four countries of the Greater Mekong Subregion—Cambodia, Laos, Thailand and Vietnam (CLTV), which is now in its sixth year of operation. This study examines the cross-border economies of the participating countries of DAN, in line with the stipulation of the sponsors that the network focus on an issue or theme of relevance to all participating countries.

*Cargo transshipping into Cambodia at a checkpoint on the Cambodia-Vietnam border.*

### The Importance of the Cross-Border Economy

The CLTV neighbourhood is one of the fastest growing subregions in the world. Growth rates experienced by the countries of the region have been consistently above 4 percent for the past decade (with the exception of Thailand, which suffered heavily from the Asian financial crisis). GDP growth of all four economies was strong in 2002, ranging from 5.5 percent in Cambodia to 7 percent in Vietnam. In general, the momentum was maintained in 2003 despite the impact of severe acute respiratory syndrome (SARS) and the war in Iraq, three of the four countries registering a growth rate of 6 percent or above. A number of factors are thought to be responsible for this success: strong consumer spending, good agricultural performance, higher export levels and appropriate fiscal stimuli in some economies.[1]

In this region of rapid change, two major economies are aggressively pursuing regional and global integration. Thailand is already well advanced in that endeavour, and Vietnam has made major steps in that direction but still has a long way to go. The region is close to China—a fact that is viewed with interest and some trepidation. The sub-region is also close to major economies like Malaysia and Indonesia, which expect very large gains from economic cooperation through broadening and deepening of markets, transfer of skills, ideas and technology and FDI flows. The CLTV countries are committed to regionalism and globalisation, and are keenly aware of the need to construct efficient, competitive market economies on the basis of their dynamic comparative advantages.

* This article is based on the fourth publication of the Development Analysis Network (DAN), which contains contributions from leading development research institutes in Cambodia, Laos, Thailand and Vietnam. The network and its research are generously supported by the Rockfeller Foundation.

## In This Issue

**Table 1: Selected Development Indicators for CLTV Countries**

| Indicator | Cambodia | Laos | Thailand | Vietnam |
|---|---|---|---|---|
| GDP growth (average, 1999–2003) | 6.3 | 6.1 | 4.5 | 6.0 |
| Human Development Index, 2001 | 0.556 | 0.525 | 0.768 | 0.688 |
| Poverty (head count, %) | | | | |
| Rural | 40.0 | 41.0 | 17.2 | 36.0 |
| Urban | 25.2 | 26.9 | 1.5 | 6.6 |
| Openness Ratio | | | | |
| 1998 | 64.3 | 62.5 | 80.0 | 72.4 |
| 2002 | 101.8 | 40.9 | 98.1 | 103.9 |
| Share of intra-regional in total trade, 2002 | 24.5 | 67.8 | 8.9 | 13.9 |

*Source: Reproduced from ADB (2004)*
*Notes: Poverty data for Cambodia refer to 1999, for Thailand 2000, for Vietnam 2002 and Laos 1996–97. Intra-regional trade refers to trade with the Greater Mekong Sub-region (GMS), which includes Cambodia, Thailand, Laos, Vietnam, Yunan and Myanmar.*

## Trade Policy and Trade Reforms

### *Thailand*

Thailand can be viewed as the gateway to this sub-region, having the largest and most developed market and being an important source of technology, knowledge and capital. Thailand has an open economy, its trade (as a percentage of GDP) exceeding 100 percent in 2004 (compared to 66 percent in 1992).[2] The Thai strategy has been characterised as "open regionalism," in which a free and open trade and investment regime is sought to be developed by 2020, through a network of bilateral preferential trading arrangements.[3]

Thailand's economic interest in its neighbours stems from a number of policy directions that it has set for itself.

Thailand is certainly interested in greater market access for its exports, especially of processed goods. It is keenly interested in developing market clusters in which neighbouring markets are closely linked to Thai raw materials, technology and investments. It is also aware of the increasing need to be able to shift sunset industries to lower cost centres. It is positioning itself as a regional economic hub, at the centre of a dynamic region grouping Indonesia, Malaysia and Vietnam.

Thailand has an AISP (ASEAN Integration System of Preferences) agreement with Cambodia and Laos. Under this agreement, 48 items are eligible to be imported from Cambodia (as of 2001) and 152 from Laos (as of 2004). The AISP has been an initiative to provide benefits to new members of ASEAN to speed up their integration with the original members. This involves the ASEAN original six granting tariff-free imports for selected products from beneficiary countries.

Thailand is well advanced in putting in place the necessary architecture of free and open cross-border trade, although the reality on the ground is changing only slowly, with implementation lagging behind.

### *Vietnam*

Vietnam is a relatively new entrant to the world of open markets and export-led growth policies. Two major events helped shape Vietnam's thrust in this direction: (a) *doi moi* in the 1980s, followed by membership of ASEAN, the ASEAN Free Trade Area (AFTA) and APEC; (b) stabilisation of foreign political relations, with China as well as with the west, after years of conflict and isolation. An unprecedented era of trade/economic liberalisation was introduced that served to generate rapid growth, huge FDI inflows and a sharp reduction in poverty.

Vietnam is keen to develop border trade as a vehicle towards greater regional integration and as preparation for WTO membership. Unlike Thailand, it has not initiated many free trade or bilateral trade agreements. It did sign a bilateral trade agreement with the USA in 2001, helping it to rapidly expand exports to that country.

Perhaps its boldest move towards a border trade policy was to pilot a border trade or special economic zone along the border with China, at Mong Cai. The experiment was carefully designed to provide the right mix of incentives and opportunities. These included (a) autonomy for local authorities to manage cross-border trade activities; (b) preferential treatment, allowing re-exports and transit trade and providing infrastructure and facilities; (c) tourism facilitation, e.g. through simplification of visa procedures; (d) fiscal decentralisation and (e) generous tax and duty incentives.

Overall, Vietnam is keen to pursue cross-border trade opportunities to exploit comparative advantage, identify new channels for trade expansion and improve living standards of border inhabitants.

### *Cambodia*

Economic liberalisation in Cambodia began gradually from the late 1980s–early 1990s, with the ending of the state monopoly on foreign trade, enactment of a foreign investment law, the lifting of quantitative restrictions on imports and abolition of licensing requirements for trade. In the late 1990s, Cambodia joined ASEAN and became a member of the AFTA. In 2001, the tariff structure was reorganised with the introduction of a four-tier tariff band, ranging from 7 to 70 percent. In addition, a generous package of incentives was put together, which appears highly competitive compared with other regional countries. Further, wide-ranging reforms are envisaged under the 2003–08 programme to reform and modernise the customs and excise department.

Cambodia is beginning to wake up to the realities implied by WTO accession. It does not have as clear and vigorous a policy to promote cross-border trade as do Thailand and Vietnam. Nor has much investment gone into the establishment of border economic zones. Cross-border trade for Cambodia remains low key, informal or semi-formal. However, confronted with the imminent end of the Multi-Fibre Agreement (MFA), Cambodia is keenly aware of the need to diversify into new markets. It is thus looking eagerly to its neighbours. In many ways, it has forged ahead at a faster pace in putting legislative and policy frameworks in place (compared to Laos and Vietnam), and in articulating policy and reform needs. The next step is to begin implementation of the reform agenda to create a competitive, pro-trade environment.

### *Laos*

Laos is unique amongst the four countries. As a land-locked country, for Laos, cross-border trade is synonymous with foreign trade and is thus vital to its economy.

Like Vietnam and Cambodia, Laos is a transitional economy, grappling with the problem of moving towards a market-driven (as opposed to a centrally planned) economy. In this context, a number of important steps have been taken.

In 1986 the government adopted a relatively comprehensive reform programme called the New Economic Mechanism (NEM), aimed at achieving a transition from a command economy to a market-driven one, and from subsistence production to a more advanced, private-sector-led agriculture, under the guidance of the government. The NEM was the first formal step to pave the way towards economic liberalisation. Laos joined ASEAN and the AFTA in 1997 and in 2000 established a joint trade committee with Thailand. Laos operates a total of 75 border checkpoints and has established two border economic zones (BEZ).

The study reveals problems with arbitrary exercise of power by local authorities, e.g. in setting duties and taxes, making it difficult to predict these costs. The study also points to the problem of a poor banking infrastructure, high bank charges and severe currency instability involved in cross-border trade, making it expensive and risky.

The Lao experience with BEZ is in sharp contrast with that of Vietnam. There are many problems faced on the Lao side, including inadequate infrastructure and a weak governance and regulatory regime. A possible solution would be to develop infrastructure and services under a joint/harmonised management structure, encompassing a BEZ that straddles both countries. Such an approach would prevent the bulk of the gains of cross-border trade being appropriated by the more developed partner—a situation that is inevitable if matters are left entirely to market forces.

Laos is well aware of its strategic location bordering Myanmar, Cambodia, Vietnam, Thailand and China and the role it can play to integrate these economies through transit trade and investments. It has sought and has been assured of a number of facilities or measures by Thailand (e.g. transit facilities for Lao goods), provisions for agricultural exports and investments in cross-border infrastructure (e.g. warehouses and silos) and a bilateral payment agreement. However, many of these agreements remain unimplemented (by Thailand). The main limitation on the Lao side is not so much policy but lack of investment, poor bargaining power and poor governance.

## Structure, Conduct, Performance of Cross-Border Trade

The country case studies point to two broad trade circuits or flows for cross-border trade in all four countries: informal and more formal flows.

### *Informal flows*

These involve many small or petty traders using small amounts of capital and dealing in low-volume and usually low-value products for sale in local markets within the border zone. Frequently these traders combine different roles as independent actors or as subordinate traders working for larger traders. In the former role they invest their own or borrowed capital to buy, transport and sell to larger traders. As dependent traders they generally operate on behalf of bigger traders, typically with borrowed capital and with the stipulation that they must sell their entire consignment to the trader to whom they are indebted. In all of the border zones, the number of such small/petty traders is large, although the total volume of goods that they account for is a relatively small fraction of total trade (20–30 percent).

Very few formal mechanisms or rules affect this flow, which is either approved by law or tolerated. Usually small payments have to be made at the border. Key elements frequently associated with these informal flows include dependence on personalised relationships that have evolved over time and are sustained by repeated transactions between traders or between traders and customers. The rapid growth of the Thai-Cambodian garments processing and trading system is an excellent example of how informal arrangements based on simple incentive mechanisms (for example, repeated transactions that enable credit relations to develop and promote trust) can generate large and complex exchange systems cutting across international frontiers.

The informal sector has strong implications for anti-poverty policy and distribution of the gains from trade. It can be huge, generating work and income for myriads of small traders, processors, artisans, transport workers and so on. However, as border trade develops and becomes more formal, enterprises become larger, more complex and more competitive, often crowding out the smaller firms or individual operators. Generally, Cambodian and Lao border trade remains overwhelmingly informal and dominated by small traders. The experience on the Vietnamese border, and even more so on the Thai border, suggests that this crowding out is well under way.

### *Formal flows*

Formal trading channels account for the bulk of cross-border trade volume, some 70–80 percent of the total. These flows are formal in the sense of being recorded—requiring paper work, appropriate documentation and processing. Frequently, even these formal flows include an informal component, in terms of under-invoicing, tax evasion, partial payments and partial recording. Thus the border trade data, e.g. from the Thai and the Cambodian sides, are often difficult to reconcile. Table 2 dramatically describes the sharp discrepancy in the official trade data between the two countries. Similarly, a comparison with the Vietnamese and Cambodia data also throws up significant discrepancies, although these are not as dramatic.

The formal flows tend to be dominated by big traders, who are able to mobilise large amounts of capital. These traders provide multiple services, including transport, payments, clearing and forwarding, handling and storage. In addition, they have excellent networking with border trade officials, including customs and immigration. In fact, there is a distinct impression that, in some cases at least, border trade is closely controlled by a small number of powerful intermediaries acting in collusion with border authorities and able to restrict entry.

**Table 2: An Estimate of Underreporting of Trade (Thailand and Cambodia— US$ million)**

| Year | Trade Volume (Thai data) | Trade Volume (Cambodian data) | Underreporting by Cambodia (%) |
|---|---|---|---|
| 1999 | 369.2 | NA | |
| 2000 | 359.0 | 245 | 46.5 |
| 2001 | 481.3 | 236 | 104.0 |
| 2002 | 527.4 | 246 | 114.4 |
| 2003 | 697.6 | 235 | 196.9 |
| Total | 2434.5 | 962 | 153.2 |

*Source: Ministries of Commerce of Thailand and Cambodia*

Thus cross-border trade involves not only economic intermediation, i.e. buying and selling in response to market demand and supply, but also, crucially, the ability of powerful trade lobbies to bypass or subvert local rules/ authorities to maximise their gains. The other side of the coin is the ability of these intermediaries to assume multiple tasks—a kind of one-stop service for importers/ exporters frequently based in cities. In other words, the formal sector would appear to have strong non-formal characteristics as well, making bipolar categories such as formal-informal not always meaningful. The clearest example of "oligopolistic control" emerged from the Cambodian study, but this is certainly not an isolated Cambodian phenomenon.

## Welfare Impact

### *Cambodia*

The economically active populations along the border with Thailand are heavily dependent on cross-border activities—garment activities, trade, transport, construction and services. There is also a significant seasonal movement of agricultural labour to Thailand. The poverty reduction impacts of these activities are likely to be considerable. The impact along the Vietnamese border (e.g. in Bavet) is much more muted but nevertheless positive.

Much of the direct impact of cross-border economic exchanges (CBE) occurs through the labour market. In seven villages (out of 20 surveyed) along the border with Thailand, cross-border labour market activity was found to be very high, with another four reporting quite significant links with CBE. In Chantrea district along the border with Vietnam, important labour market links were identified in half of the villages surveyed, while the rest reported little impact. Other benefits reported from Chantrea relate to the availability of cheap imports from Vietnam (farm inputs, agricultural machinery and food).

### *Laos*

The Lao report also suggests that the CBE impact along the borders with Thailand and Vietnam is positive. It attributes generally higher agricultural yields along the Thai border to easier access to Thai technology and inputs. It also notes the availability of cheap consumer goods from Vietnam. In general, the increased market access to neighbouring countries does not appear to have resulted in a significant increase in supply, exports of goods and services or employment and earnings—largely due to human resources, infrastructure and investment constraints.

### *Vietnam*

In Vietnam, participation in the cross-border economy "has proved to be an appropriate way for people to escape poverty." This is clearly brought out by the significant differences in living standards between participants and non-participants in CBE that the study reports. Indeed, the government is so encouraged by its success with BEZ that it has decided to replicate the model across 19 provinces and 24 border points all over the country—particularly targeting remote, backward areas and ethnic minorities, in a deliberate effort to reduce pockets of poverty and disadvantage.

### *Thailand*

At the village and household level, living standards have reportedly risen over the past five years. Clearly, there has been some impact of the cross-border economy as households residing within five kilometres of the checkpoint, e.g. at Poipet-Talat Rong Kluea, are generally found to have higher income and consumption levels. The direct benefits, however, appear to occur mainly along the major communication arteries, through the labour market and the services sector (hotels, restaurants, guest houses).

In summary, this study finds greater levels of economic activity along some borders (e.g. Poipet) and in some countries (e.g. Vietnam). The Vietnam experience with its BEZ in Mong Cai (on the Chinese border) has been excellent. The experience on the Vietnam side of the Lao-Vietnamese border has also been very good. Similarly, the Poipet area in Cambodia reports very positive impact, while the impact in the Bavet area (on the Vietnamese border) seems rather small.

Generally, direct benefits are limited, often confined to the areas along the major communication arteries. On the other hand, the impact of the BEZ tends to be much greater. Indirect effects, however, appear to be large, mainly through higher consumption levels and increased real incomes (due to the availability of cheaper imports).

## Conclusion

The more advanced countries are clearly better poised to gain from cross-border trade. Such trade is vital for Laos and increasingly important for Cambodia, especially in adjusting to the post-MFA world of quota-free trade in garments. However, Laos and Cambodia lag far behind in terms of a clear, implementable policy, i.e. in moving quickly towards establishing the basic legal, physical and institutional infrastructure necessary—despite many policy pronouncements to that end.

## Endnotes

1. See Asian Development Bank (2004), T*he Mekong Region, an Economic Overview*.
2. It is interesting if curious to note that Cambodia and Vietnam are more open than Thailand (Table 1).
3. Open regionalism implies that trade concessions provided in bilateral agreements would also be available to others in the region, e.g. ASEAN members.