CHAPTER 1

Introduction

Yasushi Ueki, Mitsuhiro Kagami, and

Teerana Bhongmakapat

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CHAPTER 1

INTRODUCTION

Yasushi Ueki, Mitsuhiro Kagami, and Teerana Bhongmakapat

1. BACKGROUND AND OBJECTIVES

Previous studies conducted by the Bangkok Research Center (BRC) in 2008 and 2009 clarified the current state of economic relationships including trade, foreign direct investment (FDI), and official development assistance (ODA) between CLMV countries (Cambodia, Lao PDR, Myanmar, and Vietnam) and advanced East Asian countries, such as China, Japan, South Korea, and Thailand. These studies show active involvement by China and South Korea in the Mekong River Basin Countries (MRBCs), in particular CLMV (Kagami 2009, 2010). On the other hand, the CLMV countries have boosted economic development by deepening regional integration with the original members of ASEAN through the establishment of the ASEAN Economic Community (AEC) and by developing closer economic and diplomatic relationships with East Asian countries so as to be involved with production networks in East Asia and to promote infrastructure and industrial development. The increase in the importance of the intermediate goods trade in the MRBCs may reflect the current progress of the CLMV strategy for economic development (Kagami 2011).

The rapid economic growth in CLMV, stimulated by the integration process, has

created a virtuous cycle of industrial development, income growth, expansion of domestic consumer and business markets, and urbanization. On the other hand, it has widened gaps in economic development between countries and between regions within countries. In the context of ASEAN economic integration, the most urgent policy issue is narrowing the income gap between the original members of ASEAN and the CLMV countries. Although this growth is needed to create new industries and upgrade existing ones, there has been little progress to date in resolving the problem except in Vietnam (in this context).

On the other hand, ASEAN seeks to establish the AEC by 2015. To realize the free flow of goods that the AEC envisages, the six original members of ASEAN eliminated almost all import duties under AFTA in 2010. By 2015, the new members of ASEAN, or CLMV, are also scheduled to eliminate, in principle, all import duties on the trade in goods. In addition, free-trade agreements (FTAs) between ASEAN and six neighboring nations (China, Korea, Japan, India, Australia, and New Zealand) entered into force in 2010. At the same time, individual member countries of ASEAN have actively concluded bilateral FTAs with the above countries. They anticipate a rapid increase in FDI in ASEAN from these six countries and from intra-regional trade. As a result, East Asia will become the factory to the world and the largest global consumer market.

It is quite certain that competition will become tighter not only among the MRBCs, but also among the members of ASEAN as the AEC comes into being. Will the CLMV countries be left behind by the advanced ASEAN countries or catch up with them? This is a critically important issue for the success of the AEC. Much depends on the CLMV industrial development and division of labor among MRBCs and between CLMV and advanced East Asian countries, including ASEAN member countries,

which should culminate in a more open market economy by removing economic barriers under the framework of the AEC.

Previous research conducted by the BRC (Kagami 2009, 2010, 2011) noted the CLMV comparative advantages in apparel, footwear, two-wheeled transport (motorcycles and bicycles), natural resource-based products, mining, hydro-power generation, and so on. It also inferred that possible new industries may include contract farming, a cut-flower cultivation and transport system, biomass energy, bio-based materials and other bio-industries, health food, pet food, electric bicycles, lenses and other optical apparatus, mineral products, gem processing, electronic components, tourism (including eco-tours), real estate, and other services. However, more effective evidence-based policy measures to attract new industries are indispensable for CLMV countries to catch up with established ASEAN members.

The BRC Research Project 2011 focused on the industrial adjustment processes in the MRBCs to expected structural changes in business environments. The BRC organized a research team composed of experts from the CLMV, Thailand, China, Japan, and South Korea to examine the division of labor from the perspectives of each country. Each member of the team attempted to observe the current status of industrial activities and comparative advantages that each country has, investigate structural impediments to industrial development, and suggest new industrial development strategies advisable for the CLMV countries to promote trade, investment, and industrial development, and eliminate the gaps between established and new ASEAN members by developing new higher value-added industries. Preliminary results of their studies were presented at an international workshop held at the Korea Institute for International Economic Policy (KIEP) in Seoul, Korea on January 27-28, 2012 to

further understand these themes, identify potential industries, and derive policy implications. This introductory chapter summarizes findings from papers and discussions at the workshop.

2. FINDINGS FROM THE PROJECT PAPERS

This report is composed of an introduction and 10 chapters on case studies. The five chapters following the introduction are country studies on industrial readjustments in the MRBCs toward the creation of the AEC. They discuss the current situation of industrial development and policies to readjust industrial structures to the new business environments expected after the advent of the AEC. They also describe policy fields and sectors that are, or will be, prioritized from each country's perspective. The case studies in the remaining six chapters broaden perspectives at the intra-East Asian level to investigate a new division of labor with CLMV. These chapters examine the division of labor between CLMV and an advanced industrialized country in East Asia, the comparative advantages each member of the CLMV group has, the case of production networks in the automotive industry, the potential of the biomass energy industry, the influence of Japanese companies' strategic behaviors, and so forth. Each chapter is briefly introduced below.

In Chapter 2, Chap Sotharith discusses challenges for Cambodia in industrial readjustment. In its development policy, Cambodia has promoted a rectangular strategy that seeks efficiency, equity, employment, and growth. But Cambodia lacks a long-term strategic plan for industrialization, and faces such challenges as the development of special economic zones (SEZs), lack of power supply, high electricity

price, unclear policy for promoting extractive industries, and the development of small and medium-sized enterprises (SMEs). The author emphasizes the necessity to formulate related policies and institutional coordination, enhance capabilities of policy implementation, strengthen technical skills, improve quality control, and provide special incentives for promoting FDI by selected sectors in SEZs in order to create more jobs, reduce disparity, and promote technology transfer.

Chapter 3 by Syviengxay Oraboune offers an overview of the industrial policy toward the 2020 vision of Lao PDR to graduate from least-developed country (LDC) status by 2020. Although the economic development of Lao PDR has significantly improved in the last decades, human capital development has not paralleled its advance. To achieve the 2020 vision, the country needs two growth engines. One includes a high economic growth sector, such as hydropower development and potential electricity-related manufacturing like electric motorcycle assembly, and development of the mining sector, including a domestic processing industry. The other is a sustainable development sector, such as a potential agricultural sector like organic farming, medicinal herbs and plants, and eco-tourism. Official development assistance (ODA) is indispensable to improve land links and human resource development toward knowledge-based economies.

San Thein, in Chapter 4, examines the preparedness of Myanmar for the AEC with special focus on the agro-industry. Myanmar has major resources, agro-based industries, and a dominant SME sector. But private businesses have been faced with serious constraints, such as a shortage of electricity, limited access to bank loans, and under-utilization of capacity. Although the agro-industry has potential, its competitiveness depends mostly on low prices for agricultural commodities. There is a

great deal of room to improve the quality of commodities and agricultural production. The new parliamentary democracy government, which took over the reins of the country from prolonged military rule on 30 March, 2011, has accelerated an industrial restructuring process in alignment with the AEC integration framework.

Chapter 5, by Ha Thi Hong Van, puts a special focus on Vietnam's new 10-year Socio-Economic Development Strategy for 2011-2020. In order to modernize industries and enhance the competitiveness of existing industries, this new development strategy provides policy directions for the following three industry groups. The competitive industry group, which includes agriculture, forestry, fisheries and related processing industries, and labor-intensive industries such as apparel, footwear, and wooden furniture, is expected to be expanded to rural areas on the one hand and needs to create higher added value in urban areas on the other. In this group, the private sector will play a key role in creating more jobs, enhancing design and development capabilities, and developing related supporting industries. The basic industry group is composed of heavy and chemical industries and mining, oil, gas, and power supply industries. Here, state-owned enterprises are likely to take the initiative. Vietnam also seeks to develop a potential industry group, which is more knowledge-based than the previous two groups, by promoting private investment and attracting FDI. The strategic development of industrial zones to set up these industry groups according to local comparative advantages is crucial to achieve the target.

In Chapter 6, Kriengkrai Techakanont explained the division of labor in the automotive industry between Thailand and the CLMV countries by using UN Comtrade trade statistics and case studies of automotive parts suppliers. The division of labor in automotive parts can be observed only between Thailand and Vietnam:

Thailand specializes in automobile production and automotive parts and Vietnam in motorcycles and some labor-intensive automotive parts like wire harnesses. In the near future, labor-intensive and mature technology production may expand to Cambodia and Lao PDR. The CLMV need to specify their potential industries according to their competitive advantage, develop necessary infrastructure and human capital, and formulate clear industrial policies as Thailand has done.

In Chapter 7, Mitsuhiro Kagami reviewed the present energy situation in MRBCs and examined the possibility of biomass energy development in these countries. Biomass energy is a convenient, renewable, and carbon-free energy source. Several biomass crops are appropriate in fertile monsoon areas like those of the MRBCs. That is why biomass energy has become one of the most recommended alternatives to fossil fuels and nuclear energy. A large number of people have doubts concerning nuclear energy due to the accident at the Fukushima Nuclear Power Plant in March, 2011 in Japan. Japan and Germany have revised their energy policies so as not to rely on nuclear energy in the future. Thailand is the first country in Asia to produce biofuels such as E10, E20, and D5. The author recommends the development of nature-friendly biomass energy to the MRBCs.

Chapter 8, by Minoru Makishima, discussed potential industries in the CLMV countries from the perspective of Japan's New Growth Strategy developed to remedy its stagnant economy. Although the CLMV countries have been generally regarded as sites for labor-intensive processes complementary to related industries in China and Thailand, Japanese enterprises have recently emphasized Asia as a potential market and encouraged active involvement in industrial development to serve local demands. In his case study, the author identified the medical appliances industry, new town

development, water supply and sewage projects, and housing and its equipment industry as new potential industries for the CLMV countries.

In Chapter 9, Xingmin Yin examines implications of regional fragmentation of production for trade patterns and the division of labor between China and CLMV. The analysis revealed that China has not only emerged as an exporting partner for CLMV within regional production networks, but has also played a growing role as an importer of components and parts from Cambodia and Vietnam. In particular, the intermediate goods trade has certainly strengthened economic interdependence between China and CLMV, especially Cambodia and Vietnam. However, the degree of the regional cross-border production networks depends significantly on the individual country's comparative advantages and manufacturing capacities.

In Chapter 10, Jaewan Cheong attempted to analyze the manufacturing industry of the CLMV countries, focusing on structural changes and competitiveness. The result can be summarized as reduced emphasis on labor intensive industries, and increased attention paid to high value-added industries. All the CLMV countries have comparative advantages and export specialization in the clothing and wood product sectors. Trade pattern analysis indicates that the CLM countries were still at the inter-industry trade level in most industries, whereas Vietnam strengthened its level of intra-industry trade. From the dynamic Normalized Revealed Comparative Advantage (NRCA) analysis, the author expects CLMV will develop mainly in the field of light industries, particularly food, clothing, textiles, and wood products. Moreover, the prospects of development for industries of CLMV utilizing their natural resources and farming infrastructure are also bright.

In the final chapter, Yasushi Ueki applied a constant market shares analysis

(CMSA) to Japan's import statistics during the periods of October 2008 and October 2011. The result of the CMSA shows that although CLM compete against each other, they posted gains from advanced ASEAN and East Asian countries, including China. Vietnam is gradually developing new export industries like medical and surgical instruments. But apparel and footwear are still major export items for CLMV. CLMV gains in apparel competitiveness are attributed mainly to China, while they suffered losses to Bangladesh. Less developed countries are catching up with the CLMV countries. Consequently, they will need to upgrade apparel and footwear products or diversify industrial activities.

3. TENTATIVE SUMMARY AND POLICY IMPLICATIONS

3.1. Evidence from Current Industrial Development

- CLMV countries currently have comparative advantages in:
  - Agriculture, fishery, and processed products
  - Forestry and wood products
  - Apparel and footwear
- Industrial sector as an engine of economic growth:
  - Decrease in the share of agriculture and relative stability in the share of services in GDP by economic activity
  - Significant role of FDI in triggering development of new industries, exports, technology transfer, and upgrading industrial activities
- Key factors for industrial development:
  - Export-oriented industrial policy and incentives to FDI
  - Significant impact of SEZs, and road, power and other infrastructure developments supported by ODA
  - Improvements in the quality of education and labor force for industrial upgrading
- Positive impact of wage inflation on coastal areas; China on CLMV industrial development:

- Transfer labor-intensive processes from China to CLMV, while China is promoting automation
- Diversification of industries in CLMV

3.2. Potential Industries in New Business Environments in the AEC

- New business environments:
  - Freer movement of goods, investment, and people, and freer market competition being created toward AEC
  - Urbanization and creation of new domestic demand for goods and services
  - Increase in awareness of the need for environment-friendly economic development.

- Potential industries (For more details, see **Table**):
  - Light industries (apparel, footwear, handicrafts, etc.)
  - Food processing, and rubber, wood and other processed products, using locally available raw materials
  - Mining and natural resource-based industries according to natural resource endowment
  - Horizontal division of labor as a global factory
    - ✓ Electric and electronic products and parts
    - ✓ Automotive parts
    - ✓ Precision instruments, including optical and medical equipment
    - ✓ Labor-intensive, but not manual speed-is-everything work
  - Renewable energy (biomass, hydropower, etc.) and biomass crop cultivation
  - Construction, including physical infrastructure development and construction materials
  - Tourism, especially eco-tourism (and medical tourism for Thailand)
  - Services and domestic demand-oriented industries (demand stimulated by urbanization)
    - ✓ Construction of housing, new towns, and urban infrastructure
    - ✓ Medical and nursing services
    - ✓ Infrastructure services (public transportation, water supply and sewage, power supply, etc.)
    - ✓ Other services and creative, knowledge-based industries appropriate to modern urban life

3.3. Policy Implications

- Obstacles for industrial development:
  - Low productivity
    - ✓ CLMV's productivity in manufacturing may be 1/3-1/2 compared to China
    - ✓ Low yield and low quality in agriculture (especially Myanmar)
    - ✓ Labor shortage and wage inflation in major industrial districts in CLMV
  - Lack of linkage between export industries and domestic supporting industries:
    - ✓ Undeveloped supporting industries
    - ✓ Dominance of SMEs
  - Insufficient infrastructure:
    - ✓ Road and railway links
    - ✓ Electricity, except Lao PDR
    - ✓ Irrigation
  - Quality of services:
    - ✓ Tourism, for example (only investments in physical facilities)
    - ✓ Lack of quality public services in newly developed residential areas

- Need for strategic development of SEZs and road, power and other infrastructure development under long-term industrial development policy
  - Extension of East Asian production networks to peripheries
  - Better irrigation, drainage, and flood control for both agricultural and industrial development

- Need for further efforts to cultivate human resources and ensure industrialization:
  - Promotion of FDI and intra-firm technology transfer within MRBCs (China→CV, T→CLM, V→CLM)
  - Improvement of compulsory education and vocational training, and upgrade in quality of educational institutions are fundamental conditions
  - Capacity building of government officials necessary for so-called plan-do-check-act (PDCA) cycle.

Table. New Strategic Industrial Sectors in MRBCs towards AEC 2015 (Based on our Study FY2011)

	Emerging Industries	Cambodia	Lao PDR	Myanmar	Vietnam	Thailand
1	Food Processing	○	○	○	○	○
2	Feedstuff, Pet Food	○	○	○	○	○
3	Wood Processing, Furniture	○	○	○	◎	○
4	Handicraft	○	○	○	○	○
5	Rubber Products	○	○	○	○	○
6	Oriental Medicine (Biochemical)	○	○	○	○	○
7	Biomass Energy (Ethanol, Biodiesel)	○	○	○	○	◎
8	Oil Refinery, Coke-oven Products	○		○	○	○
9	Mineral Processing		○	○	○	
10	Glass & Glass Products	○	○	○	○	○
11	Jewel	○		○		○
12	Textile & Clothing	○	○	○	○	○
13	Footwear	○	○	○	○	
14	Leather Products	○	○	○	○	
15	Prefabricated Housing				○	◎
16	Construction Materials	○	○	○	○	○
17	IT Parts				○	◎
18	Electric Products and Parts				○	○
19	Automobile				○	◎
20	Auto Parts		○	○	○	◎
21	Wire Harness	○	○	○	○	○
22	Motorcycle, Electric Bicycle	○	○	○	◎	○
23	Medical Instruments				◎	○
24	Precision Products and Parts			○	○	◎
25	Tourism	○	○	○	○	○
26	Medical Services					◎
27	Electricity and related resources (natural gas)		○	○	○	
28	Real estate and apartment	○	○	○	○	○

Note: ◎ Main supplier.

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