



Mobilizing Aid for Trade: Focus Asia and the Pacific

19-20 September 2007, ADB Headquarters, Manila, Philippines

Conference Proceedings

Co-hosted by the Asian Development Bank,
the Philippine Government,
and the World Trade Organization

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EXECUTIVE SUMMARY

The Asia and the Pacific regional Aid-for-Trade review was held on 19–20 September 2007 in Manila, Philippines, co-hosted by the Asian Development Bank (ADB), the Philippine Government, and World Trade Organization (WTO) with the collaboration of the World Bank. Co-chaired by ADB President Haruhiko Kuroda and WTO Director-General Pascal Lamy, it brought together over 400 representatives from governments, international organizations, donor agencies, and the private sector. High-level participants included the Philippine President, the Prime Minister of Tonga, 10 trade and finance ministers, and four heads of international organizations. The review meeting aimed to (i) identify the main trade needs and priorities for addressing them—both nationally and regionally; (ii) encourage recipient countries/subregions to formulate “business plans”; (iii) encourage donors to develop a detailed response and scale-up trade-related development assistance in the region; and (iv) secure the political commitment to follow through on the Aid-for-Trade agenda in the region.

There was a widespread recognition at the Manila review of the “two faces” of development in Asia and the Pacific. While a group of countries such as the newly industrialized economies (NIEs), People’s Republic of China, and India, have responded well to globalization, reducing trade barriers, boosting economic growth, and lifting millions out of poverty, a larger group of least developed countries (LDCs), small states, and other developing countries in the region still struggle to fully benefit from trade. Emphasis on outward-oriented development strategies, investments in modern infrastructure and human capital upgrading help to explain the performance of the first face of Asia and the Pacific. Meanwhile, the other face is characterized by countries that are landlocked, isolated, with fragmented markets, in a post-conflict environment, or otherwise lack the capacity to trade. These countries are thus in need of greater assistance to prosper from global trade.

Within this context, the Manila review highlighted the importance of a coherent approach to Aid for Trade in Asia and the Pacific, tailored to diverse subregional and national needs. Furthermore, recipient countries called on donors to provide additionality for Aid-for-Trade programs in line with the Paris Principles. There was also acknowledgement that policy lessons from the region’s success stories (for example, outward-oriented strategies and private-public sector partnerships) had relevance for national development strategies in other economies in the region.

The sessions identified several common themes that will help shape the future Aid-for-Trade agenda in the region: (i) the importance of regional cooperation and integration; (ii) the need for better cross-border infrastructure; (iii) the need for further assistance to countries in their efforts at trade facilitation; (iv) the need to develop trade finance markets through public-private sector partnerships; and (v) close adherence to the principles of the Paris Declaration, in terms of harmonization of donor procedures, mutual accountability, and alignment to donor partnerships.

The review participants agreed on the need to take the Aid-for-Trade initiative in Asia and the Pacific forward into 2008 and beyond. To this end, the ADB and WTO were tasked with preparing a short report on the outcome of the Manila review and the next steps to be presented at the WTO’s Global Aid for Trade Review in Geneva on 20-21 November 2007.

CONFERENCE PROGRAM

PROGRAM

18 September 2007

- 13:00–15:00 Registration
ADB Auditorium Lobby
- 16:00–20:00 Registration
Ballroom 1 EDSA Shangri-La Hotel, 1 Garden Way, Ortigas Center, Mandaluyong City
- 18:00–20:00 Welcome Cocktail Reception
Ballrooms 2 to 4, EDSA Shangri-la Hotel, 1 Garden Way, Ortigas Center, Mandaluyong City

19 September 2007

- 07:45–08:45 Registration
ADB Auditorium Lobby
- 09:00–09:30 OPENING REMARKS—Aid for Trade in Asia and the Pacific
ADB Auditorium
- 09:30–09:40 Break
ADB Auditorium Lobby
- 09:40–10:55 PLENARY 1—Why “Aid for Trade” Matters in Asia and the Pacific
ADB Auditorium Zones A and B
- 10:55–11:15 Networking Break
ADB Auditorium Lobby
- 11:15–12:30 PLENARY 2—Public-Private Sector Partnerships for Aft in Asia and the Pacific
ADB Auditorium Zones A and B
- 12:30–14:00 Lunch
ADB Executive Dining Room
- 14:00–17:00 PARALLEL BREAK OUT SESSIONS
- Greater Mekong Subregion (GMS) Session**—Country Adjustments to Trade Liberalization and the Global Trade Environment: Support Requirements and Aid Agenda
ADB Auditorium Zone B
- 14:00–15:15 Session 1: Scope of Aid for Trade in the GMS
- 15:15–15:35 Networking Break
- 15:35–17:00 Session 2: Key sector issues related to Aid for Trade under the GMS
Economic Cooperation Program

South Asia Session—Reaping the Benefit from Trade Infrastructure, Value Chain Investment, and Supply Capacity Building in South Asia
ADB Auditorium Zone C

14:00–15:15 Session 1: Scope of Aid for Trade in South Asia

15:15–15:35 Networking Break

15:35–17:00 Session 2: Taking stock of sector issues related to Aid for Trade

Philippines Session—Promoting Competitiveness and Enhancing Export Capability, An Aid for Trade Strategy
ADB Auditorium Zone D

14:00–15:15 Session 1: Scope of Aid for Trade in the Philippines

15:15–15:35 Networking Break

15:35–17:00 Session 2: Taking stock of sector issues related to Aid for Trade

17:30–20:00 Dinner Reception
ADB Executive Dining Room

20 September 2007

08:00–09:30 PLENARY 3—Ministerial Roundtable on AfT in Asia and the Pacific
ADB Auditorium

10:00–10:30 KEYNOTE ADDRESS
ADB Auditorium

10:30–10:50 Networking Break

10:50–12:05 PLENARY 4—Donor Partnerships for AfT in Asia and the Pacific
ADB Auditorium

12:05–12:25 CLOSING REMARKS—Summary and Next Steps
ADB Auditorium

12:25–14:00 Lunch
ADB Executive Dining Room

SIDE EVENTS

18 September 2007

Workshop on Standards and Trade Development Facility Organized by the World Trade Organization

ADB Auditorium A

08:30–09:00	Registration
09:00–09:15	Opening Remarks
09:15–09:45	Session 1: Addressing the challenge of the increasing importance of SPS measures on international trade
09:45–11:15	Session 2: Strengthening the demand side – SPS needs in Cambodia, Lao P.D.R and Vietnam
11:15–11:30	Coffee Break
11:30–12:45	Session 3: The view from the private sector
12:45–14:15	Lunch Break
14:15–16:00	Session 4: Assessing the supply side of SPS related assistance – Compilation of selected donors' assistance in Cambodia, Lao People's Democratic Republic (P.D.R) and Vietnam
16:00–16:15	Coffee Break
16:15–17:30	Session 5: Bridging the gap between supply and demand – Lessons learnt from existing processes
17:30–17:45	Closing Remarks

Workshop on Private Sector and Aid for Trade Organized by the International Trade Center

ADB Briefing Room

08:30–09:00	Registration
09:00–09:15	Opening Remarks
09:15--11:00	Session 1: Role of Private Sector in the Formulation of Trade Policy and Regulations
11:00–11:30	Coffee Break
11:30–13:00	Session 2: Role of Private Sector in Building Trade-Related Infrastructure
13:00–15:00	Lunch Break
15:00–17:00	Session 3: SMEs Overcoming Supply-Side Constraints

20 September 2007

**OECD Practitioners Forum: Making the Most of Aid for Trade Organized by the
Organization for Economic Cooperation and Development**

ADB Briefing Room/Display Room

14:30–14:45	Welcome and Opening Remarks
14:45–15:45	Session 1: Monitoring Aid For Trade: Why and How?
15:45–16:00	Coffee Break
16:00–18:00	Parallel Sessions
	Session 2: What to Report to the WTO Aid for Trade Review? Briefing Room
	Session 3: From Needs Diagnostics to Results: Addressing, Implementation and Challenges Display Room
18:00–18:30	Concluding Session

OPENING REMARKS

Aid for Trade and the ADB Experience
Haruhiko Kuroda
President, Asian Development Bank

Wednesday, September 19, 2007
Asian Development Bank Headquarters, Mandaluyong City

Aid for Trade and the ADB Experience

Opening Remarks

Haruhiko Kuroda
President, Asian Development Bank
Wednesday, September 19, 2007
Asian Development Bank Headquarters, Mandaluyong City

I. Introduction

Your Excellency Prime Minister Sevele, Director-General Lamy, Honorable Ministers, distinguished guests, ladies and gentlemen:

It is a great pleasure for me to welcome you all to this milestone event. The very large number of senior ministers and private sector participants in attendance shows the significance that governments, institutions, and corporations in Asia and the Pacific place on the outcome of this regional review meeting. Many of you have traveled a long way to come to Manila, and we are most grateful for your participation.

Regional development banks-ADB among them-have been a part of the Aid-for-Trade initiative from the start. In June 2006, I met with World Trade Organization Director-General Lamy and other regional development bank presidents to express our joint support to strengthen inter-institutional coordination to effectively deliver on this initiative. One year on, ADB has worked as a member of the WTO Advisory Group and, as part of the 2007 Aid-for-Trade Roadmap, we are proud to co-host this meeting with WTO and the Government of the Philippines. I would also like to thank the WTO and the Philippine government for the excellent cooperation and preparations for this event.

In our view, Aid-for-Trade is critically important to help less developed countries and small states in our region benefit from increased trade and economic growth, as well as from economic cooperation and integration. We all, however, need to focus on ways to make it viable, efficient, and effective. To this end, I would like to offer some observations based on ADB's own experience in trade-related development, and some thoughts on how we can contribute to Aid-for-Trade. First, however, let's have a look at why this initiative is needed now more than ever in the Asia and Pacific region.

II. Why Aid for Trade?

In the 40 years since ADB was established, most of the region's developing economies have produced tremendous benefits for their people. With outward-looking development strategies, these economies have grown dramatically, expanded trade, and reduced poverty. The region's structural transformation has shifted economic activity from traditional agriculture and commodities to technology-intensive manufactured exports, and increasingly high-end services. Asia and the Pacific now accounts for over 27% of world GDP -with emerging Asia and the Pacific contributing 44% of that amount.

However, two faces of Asia and the Pacific remain. One beams the advances made by newly industrialized economies and the rapid economic expansion in China and India. This has led

to a tripling of their share of world exports since 1980, helping raise growth rates and living standards. The other face of Asia may show the desire, but still lags behind. The region's 22 least-developed and small state economies, together, account for just 0.3% of world exports - a figure that has barely increased over the past quarter century. Underlying their poor performance is the high concentration of their exports in a narrow range of commodities or services that are sensitive to even small changes in external conditions. Not surprisingly, this sluggish export performance translates into low economic growth and a relatively high incidence of poverty.

What is behind the stark contrasts in economic growth and development - the two faces of Asia? There are indeed many reasons: some countries are in a post-conflict environment; others remain in transition to market economies; while still others grapple with geographical isolation or limited markets.

ADB's long experience in trade-related development shows that successful economies have developed three basic components for vibrant trade, economic growth, and social development:

- Efficient productive capacity - essential for enterprises to benefit from open markets and greater trade opportunities;
- Effective public-private partnerships that ensure private enterprise can build upon market-driven global and regional supply chains and production networks; and
- Comprehensive cross-border connectivity to allow easy access to products, services, and people-in other words, the foundations of regional economic integration. From this perspective, if Aid for Trade is to work, it needs to be focused and demand driven. And while each economy has its own specific requirements, assistance will generally be needed with one or more of five components:
 - First, trade-related infrastructure. Transport, energy, and communications are the most obvious. This may be the most expensive, but it is also the most essential for linking to the world economy.
 - Second, productive capacity to draw countries into production chains and supply networks, whether regional or global.
 - Third, adjustment programs. New demand and economic growth require market-oriented reforms, development of social safety nets, and worker re training to ease the transition.
 - Fourth, trade development, including export promotion and trade finance.
 - And finally, trade capacity building to help DMCs negotiate and implement trade agreements.

Bringing these elements into play for our least developed partners and small states requires an effective international response. If we, as a regional and an international community, supply the resources needed to draw these economies into the international trading structure, we can help kick-start economic growth-as many economies in Asia and the Pacific know

well. And not only do we need traditional donor nations to participate in our region's Aid-for-Trade initiative, we need the engagement of the region's own growth economies as well.

III. ADB's Experience in Trade-related Assistance

I am pleased that as the main regional development partner in Asia and the Pacific, ADB can make a significant contribution to helping these countries reduce poverty through trade. For decades, we have worked with developing member countries individually to build cross-border infrastructure, facilitate trade, modernize customs procedures, enhance trade for small and medium enterprises, and support trade and investment promotion. And we have brought both finance and expertise to a number of trade-related cooperation projects between countries, including in the Greater Mekong Subregion (GMS), in the Central Asian Republics, in South Asia, and in the Pacific.

To give you just a few examples, we have invested in the Nam Theun 2 project in the Lao People's Democratic Republic - a project that illustrates the benefits of trade-related development and public-private partnerships. The 1,070 megawatt plant will generate significant revenues for poverty reduction and environmental protection in Lao PDR, while supplying much needed power to Thailand. We are also helping developing member countries improve productive capacity for trade, such as in Viet Nam-which joined the WTO last year. Just this July, ADB approved a major grant to Viet Nam to help improve the quality and safety of agricultural products, many for export. In Central Asia, we are supporting trade facilitation, customs reforms and customs modernization, and in the Pacific, we are helping the region to improve the quality and extent of air services among eight of the region's least developed countries and small states.

These efforts will be further strengthened by our Regional Cooperation and Integration (RCI) Strategy. The strategy focuses our regional work on four key pillars: cross-border infrastructure and related services, such as trade facilitation and customs modernization; trade and investment; money and finance; and regional public goods. The Strategy clearly complements the Aid-for-Trade initiative in helping to bring the vibrancy of the region as a whole to those economies that are lagging behind.

IV. ADB's Role-Advocacy, Implementation, and Monitoring

As we take stock of the priorities and needs of Asia and the Pacific over the next two days, we will be looking for opportunities to shape our support for Aid for Trade in these early days so as to help achieve its objectives in an appropriate and practical manner: Within the Aid-for-Trade framework, ADB can be an advocate to help build awareness within both the public and private sectors of the benefits and dynamics of trade. One goal is to show how mainstreaming trade development in public policy works. Another is to highlight the critical importance of private sector participation in building markets through guarantees, public-private partnerships, and export credits, among others.

As the region's development bank, ADB is a natural catalyst for helping mobilize and channel Aid-for-Trade funds effectively to implement trade-related projects and technical assistance, whether country-specific or regional in nature. We are prepared to help foster Aid for Trade in any appropriate way we can.

We are also happy to work with WTO and the Organization for Economic Co-operation and Development to monitor the performance of Aid for Trade in our region. Our institution has been part of the Technical Working Group with OECD and will, of course, continue to work closely with the World Bank and other development institutions.

This regional review meeting will set priorities for the future. Resource mobilization for the region's trade development is the important next step, as the results of similar regional conferences in Latin America and Africa will be presented at the WTO headquarter in Geneva in late November. If we get this right - and I'm confident we will - Aid-for-Trade has the potential to help bring higher levels of development, lower levels of poverty, and the benefits of lasting prosperity and peace to Asia and the Pacific, and to the world.

I wish you well in your deliberations, and look forward to the upcoming panel discussions.

Thank you.

OPENING REMARKS

Pascal Lamy
Director-General, World Trade Organization (WTO)

Wednesday, September 19, 2007
Asian Development Bank Headquarters, Mandaluyong City

Opening Remarks

Pascal Lamy

Director-General, World Trade Organization (WTO)

Wednesday, September 19, 2007

Asian Development Bank Headquarters, Mandaluyong City

Welcome to this first regional review of Aid for Trade for Asia and the Pacific. First, I want to thank our partner in this event, the Asian Development Bank. President Kuroda and his team have done the heavy lifting in terms of preparations and organization — and the superb result comes as no surprise to anyone familiar with the focus, energy and professionalism of this institution.

I also want to thank our host, the Philippines Government, which has been an enthusiastic supporter of this concept since I first discussed it with President Arroyo in April. It is entirely fitting that we are holding this event in one of the more dynamic countries in what is easily the most dynamic region of the world economy. China, India and other Asian powerhouses have offered a new model — and a new inspiration — to the developing world. One which harnesses globalization — through trade and integration — to provide an unprecedented engine for growth, rising living standards and poverty reduction. Part of our challenge over the next day and a half is to learn from Asia's success and, share the lessons.

This meeting has one purpose: helping countries in Asia and the Pacific build the capacity they need to take advantage of trade. It is part of a global initiative — launched at the WTO's 2005 Hong Kong Ministerial Conference — to scale up international financial assistance for trade capacity building in developing countries. The second of three regional conferences — following one in Lima last week and preceding one in Dar es Salaam in early October — it will provide the regional perspective on Aid for Trade, culminating in a "Global Review" in Geneva on 21–22 November.

The WTO's main contribution to growth and development — for this region and for the world — is the current Doha Round of multilateral trade negotiations. In terms of market opening and strengthened international rules, it promises to have a greater impact than the Uruguay Round. But while trade opening is indispensable to development, it is not sufficient in itself. What Asia has shown us is that countries also need access to the basic infrastructure that drives globalization — 21st century transport corridors and telecommunications networks that can connect exporters to world markets; modern customs facilities that can move products rapidly and efficiently across borders; testing labs to ensure that exports meet international standards; and the sophisticated expertise and institutions needed to navigate a highly complex world trading system.

Some of these pieces are already in place in this region but others are not, and the necessary investments cannot be supplied by poorer countries alone. Aid for Trade is about helping to fill these "gaps" — mobilizing and leveraging the required financial resources — and providing a catalyst for the increased trade, investment

and growth. It is about helping developing countries to benefit from the world trading system. But it is also about strengthening the world trading system itself — by ensuring that its opportunities are more widely shared.

These are major challenges and we only have a short time to address them — so let me suggest three key issues we should focus on:

First, the importance of national vision — backed by a comprehensive strategy for getting there. No one can tell a country how to trade or become more competitive. The only successful export-led growth strategy is one which countries want themselves — that they design and implement on their own — and that remains on course over the long-term. So the first step towards mobilizing Aid for Trade is to make trade capacity and infrastructure a national priority shared across government — including trade, finance, planning, agriculture, and other key ministries. And because trade crosses borders, these priorities are often regional in scope — which means finding new ways to finance and implement projects regionally. I hope we can spend time over the next day and a half hearing about your strategies — including your regional strategies — and how you plan to execute them.

Second, we need to focus on the financing that is required, how to mobilize it, and how to deliver it more efficiently and effectively. Yesterday you had a chance to discuss one of the existing programmes providing Aid for Trade in the area of standards. This joint programme is an example of how targeted aid for developing countries to meet food standards can help them access world markets. I hope we will have a chance over the next day and a half to discuss a broad range of programmes and projects — and the kind of resources, both development assistance and multilateral lending, needed to advance them. Part of the challenge is to get donors and international agencies to focus more on trade and growth in their own development planning — and to make the case that in today's open and integrated global economy there can be no long-term poverty reduction or other social goals without increased trade and economic growth. We are not going to close the financing gap over the next day and half. But we are going to lay out the immediate and long-term steps for doing so.

Third, we need to focus on the role of the private sector — for the simple reason that it is farmers, businesses and companies that trade, not governments. I am encouraged that we have so many private sector representatives with us. We want to hear from you about the obstacles you face and the priority steps that need to be taken. We also want hear how the private sector's views and ideas can be incorporated more directly into national trade planning and strategies. And because private investment — both foreign and domestic — must be a major part of the answer to capacity and infrastructure building, we need to focus on the incentives that are required to leverage private resources.

What we are undertaking is ambitious. I think ambition is good — it is how we will get results. But just as improvements in trade capacity and infrastructure will not happen overnight, we cannot expect — nor should we try to find — all the answers in Manila. We need to remind ourselves that this is a work in progress — and that

we are at the beginning of what will be a long road. The important thing is to get the process launched — which we are doing.

We also need to remind ourselves that there is no one magic solution to the challenges I've outlined, but many solutions — and that the answer is not to create a new mechanism, but to get the many existing mechanisms to work together more effectively. Success will depend fundamentally on “coherence” — cooperation with all of you in this room, with your colleagues in capitals, and with practitioners on the ground. This meeting is not about imposing “top down” answers. It is about raising awareness, sharing information, and creating incentives — by shining a “spotlight” on the issue — to get all of us working together to find and deliver solutions.

I started by saying that our goal is more and better Aid for Trade — all aimed at helping developing countries to take advantage of trade opening and the trading system. That is the benchmark against which our success — or failure — will be measured. But implicit in that challenge is the importance of changing mind-sets, not just building more roads and bridges. Today's global economy is fundamentally changing the development dynamic, creating huge potential for developing countries to harness trade as an engine of growth. It is my hope that this conference will encourage us to focus on the profound economic changes around us, on how to adapt to — and exploit — these changes, and on how Asia's vision of development can be spread to all countries in the region.

This is an inspiring challenge in an inspiring region. Let's get started.

PLENARY 1

CHAIRMAN'S SUMMARY

James W. Adams

Vice-President for East Asia and the Pacific, World Bank

SESSION REMARKS

Supachai Panitchpakdi

Secretary-General, UNCTAD

PLENARY 1 – Why “Aid for Trade” Matters in Asia and the Pacific

19 September 2007, 9:40-10:55 am

ADB Auditorium Zones A and B

Session Objectives

1. To provide an overview of the case for increased Aid for Trade (AFT) flows in Asia and the Pacific from the perspective of trade ministers from developing countries
2. At national and sub-regional levels, to highlight the importance of trade and growth to enable developing countries in the region to:
 - a. benefit from globalization and regional integration
 - b. map trade capacity and infrastructure needs, and
 - c. determine priorities to address them.
3. To examine the trade prospects and special needs of least developed countries (LDCs) and small states.

Session Speakers

Moderator: James W. Adams, Vice-President for East Asia and the Pacific, World Bank

Panelists:

- Supachai Panitchpakdi, Secretary-General, United Nations Conference on Trade and Development
- Thomas Aquino, Senior Undersecretary, Department of Trade and Industry, Philippines (representing Secretary Peter Favila)
- Nam Viyaketh, Minister of Industry and Commerce, Lao PDR
- Patteson Oti, Minister for Foreign Affairs, External Trade and Immigration, Solomon Islands
- Tseren Davaadorj, Minister of Industry and Trade, Mongolia
- Odil Khusnitdinovich Djuraev, Deputy Minister of Foreign Economic Relations, Investments and Trade, Uzbekistan
- Truong Dinh Tuyen, Adviser to the Prime Minister and former Minister of Trade, Vietnam Senior Undersecretary

Chairman’s Summary

James W. Adams, Vice-President for East Asia and the Pacific, World Bank

I think we had a very rich discussion and a set of presentations fully reflecting the development challenges of the region. I would just like to highlight a number of themes I think we will see re-emerging in the next couple of days. In Supachai Panitchpakdi’s very good overview, he presented the importance of the comprehensive challenge of development to the trade issue. He also noted that these are not challenges that look the same for each country, which was very much reflected in the discussion. Finally, he also underscored the important regional nature of the challenge.

There are a number of themes that emerged at the country level that I would like to highlight, because I think they do provide the framework for the discussion that will follow.

First is the emphasis on the importance of capacity development and the role of the government in that.

Second, is the consistent theme on the central role that the private sector plays in this issue.

And finally, there is the broad concern about infrastructure constraints and how to address them. I think, obviously, the aid community has a particularly strong role to play in that. And obviously infrastructure is a focus of both World Bank and ADB investments in the region.

From the Philippines, we saw very strong emphasis on some of the sophisticated issues that are facing countries in the trade challenge. This includes the issue of standards and the issue of strengthening customs.

From the Lao People's Democratic Republic, we saw a very nice summary of the comprehensive challenge that Supachai Panitchpakdi put on the table in terms of the range of issues that have to be faced to get a country specific program.

From the Solomon Islands, there was a very nice emphasis on the special challenges of the Pacific small islands, the transport challenges and, in particular, the capacity challenges.

And I think for Mongolia, we had a nice outline of the challenge of a large, land-locked country and the constraints that they face, with an emphasis on the infrastructure challenge.

With the Uzbekistan intervention, I think the regional nature of the problem and the way the region there is dealing with the challenge is particularly interesting and provides an important framework for addressing these issues. The challenge of the agriculture side was also mentioned right up front as an important area to address.

And finally, in Viet Nam, we had a nice example of a success in terms of what a comprehensive program has contributed to development, and in its aftermath. And with Viet Nam's entrance into the World Trade Organization, many of the specific challenges that still have to be faced, particularly in the area of capacity development. Even with progress and success, enormous challenges remain.

Remarks of Supachai Panitchpakdi, Secretary-General, UNCTAD

Aid for Trade (Aft) must meet four (4) conditions for success: it should be for development and not for Aft; it should cover the full range of adjustments included in Aft; it should provide predictable funding; and it should not be a substitute for other multilateral programs.

Countries can build up their capacity to integrate into the global trading system and use trade as part of the instrument for achieving investment, improving transport technology, and building a competitive advantage. Asia is a good showcase.

Nevertheless, Asia is heterogeneous. When people note that there is so much dynamism in Asia—export growth on average 18% per year, GDP growth 7-8% per year—they may question why Asia should need Aid for Trade.

All the points I will mention will show that Aid for Trade is still very appropriate for Asia and the Pacific.

First, as has been mentioned by ADB President Haruhiko Kuroda, Asia is not homogenous. We have least-developed countries in Asia. We have countries in transition. We have small countries and island states. The kind of growth we see is inequitable, and there are still countries that would need supplementary assistance to build trade capacity.

Also, there still exist obstacles in Asia for a particular group of countries. For example, we have calculated that landlocked Central Asian countries pay on average 30% more in logistical costs than other countries. There needs to be special assistance to reduce these costs or to manage trade competitiveness in a way that they can reduce the burden of transportation costs.

There are also quite a number of small island states that are very dependent on seaborne transportation. Again, there needs to be help, particularly in the way port management is done or to enhance customs procedures to improve efficiency.

Second, there are also countries in transition, from planned to market economies, that would need help to establish the kind of trade rules and regulations. Much needed assistance is required in that direction.

Third, there are ongoing negotiations between the EU and the so called ACP (Africa, Caribbean, and Pacific) countries. The ACP countries are involved in the economic partnership agreement with the EU which is supposed to be completed at the end of this year. These negotiations will give rise to all kinds of adjustments for countries that used to gain special access to the European market. Now they will not be getting that anymore, so they need assistance. By the look of things, there will be difficult negotiations before they can complete, but if the agreements are completed these countries will need adjustment assistance.

Fourth, countries living next door to high growth areas like the People's Republic of China, Southeast Asia, and India, would need to be integrated more fully to benefit from this growth. This can be challenging because they are competing sometimes in the same region and the same product sectors. There is a need for these countries, smaller countries in Asia, to adjust on their own so that they can benefit. Sometimes, they have to diversify or create new specialized benefits so that they can take advantage of emerging growth areas and be competitive.

Fifth, and this is what the ADB has been working a lot on, there is regional cooperation, which is going to happen anyway. Yet, there is a need for regional cooperation to be guided in a way that it is not based on free-trade areas alone. There are a number of regional public goods, like water management, environmental management, or the electricity connection network. There are a number of global or regional public goods that need to be incorporated into regional management so that the whole region can benefit. This has implications for Aid or Trade that we would like to see from our multilateral perspective. We would like to see that AfT should not be directed mainly at individual countries. For example, if you want to standardize food quality, doing it throughout the region will be much more helpful.

Sixth, UNCTAD has been working in various areas that the two speakers have mentioned this morning. In the areas of the private sector, we have worked on areas such as creating entrepreneurship worldwide. We have been working on automated customs procedures, helping to reduce procedures that previously took two weeks to just one day. We have been helping countries to set up their own investment policy programs so that they can attract foreign direct investments. And we have been helping countries work together in what we call south-south economic cooperation.

All these are existing programs under UNCTAD. If we can strengthen these programs by incorporating them into Aid for Trade, we would be more effective.

PLENARY 2

CHAIRMAN'S OVERVIEW AND CONCLUSION

William Pesek, Jr.
Bloomberg News

PLENARY 2 – Public-Private Sector Partnerships for AfT in Asia and the Pacific

19 September 2007, 11:15 am – 12:30 pm

ADB Auditorium Zones A and B

Session objectives:

1. To discuss how the public and private sectors can work together to foster the AfT initiative in Asia and the Pacific
2. To present the views of exporters, investors and financial institutions, many of which are insured by private and public insurers, from both developed and developing countries.
3. To reinforce the importance of free trade and the role of the private sector in financing in frastructure. map trade capacity and infrastructure needs, and determine priorities to address them.
4. To addresse areas where international and regional organizations can support the private sector

Session Speakers

Moderator: William Pesek, Jr., Columnist, Bloomberg News

Panelists:

- Lars Kolte, President, Berne Union
- Siphana Sok, Director, International Trade Centre (former Vice-Minister of Commerce, Cambodia)
- Kah Chye Tan, Global Head of Trade and Finance, Standard Chartered Bank
- John Hegeman, Senior Vice President, AIG Global Trade and Political Risk Insurance Company, Inc.
- Jonathan Kushner, Regional Director, Microsoft Asia Pacific.

Chairman's Summary

William Pesek Jr., Columnist, Bloomberg News

OPENING STATEMENT: As President Kuroda said earlier, this event is a milestone. This may be a bold statement, but I think that of all the events of these next couple days, this one is arguably the most important because this event talks about how to pay for Aid for Trade. How to do the things we want to do.

There is a great deal of consensus about the need for Aid for Trade and the need to spread the benefits. But public money can only go so far. We need the private sector to be more and more involved. And if you look at reports—I was looking at one yesterday from the World Bank—there is still a massive gap between middle and low income countries when it comes to investment.

Think of infrastructure alone. A recent World Bank study shows that infrastructure investment needed to sustain developing world growth is about 5.5% of gross

domestic product. At the moment the public sector is spending an average of about 2–4%. How do we make up the gap? Of course, we need to turn to people with deeper pockets than the public sector: the private sector.

In my research for this event I was looking around for research about what is Aid for Trade. One of my colleagues in Tokyo asked which bands are playing. I said no, it's not a benefit concert. In 2007, the word 'aid' is a dirty word. It suggests subsidy. It suggests charity. But we're talking about a very different issue. We are talking about empowering economies.

Aid for Trade is a very interesting concept because it provides a very rare nexus between the public sector and the private sector. It's not really incorrect to say that the private sector wants to make money. This is one of the rare occasions when the public and private sectors can work together, and it doesn't have to be about altruism. It's about investing in future markets, and creating the next frontier of capitalism.

As the economist John Kenneth Galbraith said, the problem isn't globalization, the problem is that the people who need globalization most don't get enough of it. Global trade talks have a ground-hog day quality to them. We've been here before, we were here a year ago, and maybe we will be a year from now.

Today we have a panel to discuss ways in which the public and private sectors can work together.

CONCLUSION: This is a very big topic. In conclusion, I think we can say that the private sector is ready and the private sector is interested. And the money is there. The public sector certainly is already involved and you can argue that in this issue, aid for trade, the public and the private sector are very much two sides of the same coin. Money is not the problem. It is about mobilizing it.

PLENARY 3

CHAIRMAN'S SUMMARY
C. Lawrence Greenwood
Vice-President, Asian Development Bank

SESSION REMARKS
Feleti Vaka'uta Sevele
Prime Minister, Tonga

PLENARY 3 – Ministerial Roundtable on AfT in Asia and the Pacific

20 September 2007, 8:00 – 9:30 am
ADB Auditorium Zones C and D

Session objective:

This session, with the participation of finance ministers among others, aimed:

1. To review reports from the breakout sessions and examine ways of effectively incorporating AfT into national development strategies in Asia and the Pacific.

Issues included efficiently allocating resources for AfT given competing demands, promoting inter-ministerial coordination and ensuring smooth donor partnerships.

Session Speakers

Moderator: C. Lawrence Greenwood, Jr., Vice-President (Operations 2),
Asian Development Bank

- Feleti Sevele, Prime Minister, Tonga
- Margarito Teves, Minister of Finance, Philippines
- Keat Chhon, Senior Minister and Minister of Economy and Finance, Cambodia
- Niko Lee-Hang, Minister of Finance, Samoa
- A.B. Mirza Azizul Islam, Adviser (Cabinet Rank) for Ministries of Commerce and Finance, Bangladesh
- Mari Elka Pangestu Minister of Trade, Indonesia

Chairman's Summary

C. Lawrence Greenwood, Vice-President, Asian Development Bank

What we have seen is a strong commitment from the people in these important countries who have decision making power about where resources go. There is a clear and strong commitment from those officials for the Aid for Trade agenda and for spending that will support export competitiveness and trade in order to spur growth and reduce poverty. We also see this commitment through the emphasis placed on the importance of investment in trade infrastructure as well as on increasing trade competitiveness more generally through technical assistance, both at the governmental and private sector levels. This commitment shows, for example, through Philippine Finance Secretary Margarito Teves statement of the country's plan for substantially increasing public investment, in particular, in infrastructure.

A great deal of emphasis was also placed on public-private partnerships and on the importance of helping the private sector by creating an enabling environment. Also, as pointed out by the Prime Minister of Tonga, direct assistance to the private sector will help it better compete by providing assistance that will help small- and medium-sized enterprises better access to international markets.

You also heard the importance placed on adjustment costs from Minister Mari Pangestu. In addition to trade competitiveness, we heard about the importance of making sure that the adjustment costs for those who will have to adjust to more open trade are factored in to the Aid for Trade agenda. The importance of regional cooperation and improving and expanding economies of scale was also discussed.

It is clear from all the presentations that national budgets alone cannot support this comprehensive agenda. Additional resources from donors are very much needed. As Prime Minister Sevele pointed out, billions are needed, and there is a need for donors to follow through on these pledges. He expressed some disappointment and distress that the needed assistance was not forthcoming as much as we had hoped, and that small island countries such as Tonga are missing out on the benefits of trade liberalization.

All of the panelists expressed the need for additionality: that external assistance be multi-year, predictable and that it not come with undue conditionality.

Minister Pangestu pointed out the need for a very clear needs analysis and costing plan in order to set priorities and to enable countries to approach donors with very clear time lines and requirements. This will be very important as we look at what the region's needs particularly in consideration of the WTO global review.

The need for closer donor coordination to make Aid for Trade assistance more effective was also highlighted.

Finally, a number of panelists pointed out that one of the most important things developed countries can do, and in fact that the developing community can do, is follow through with completion of the Doha round in recognition of the fact that trade liberalization itself is the most important way to allow trade to drive growth.

Remarks of Feleti Vaka'uta Sevele, Prime Minister, Tonga

I would like to thank you for inviting some of us from the Pacific Islands here to fully participate in the discussion about Aid for Trade.

Yesterday we heard two excellent addresses by the President of the ADB and the Director-General of the World Trade Organization. In setting out, clearly, the rationale for, and the imperative of, the Aid for Trade initiative, these addresses also challenge us from the developing countries and from the small island countries of the Pacific to come up with some practical suggestions as to how, in partnership with the donor community, we may move forward meaningfully and successfully.

At the HK ministerial conference, several developed countries announced billions of dollars in additional, and I stress the word additional, aid towards the AfT initiative: Japan alone with some \$10 billion over a 3-year period. The US and the EU also promised billions of dollars towards the small developing countries, in return, as I understand it, for joining the WTO, and for the formidable challenges that they face as a result.

After HK, we are now two years on and we are still talking, trying to formulate the best possible way forward. In the meantime, much of the benefit from trade liberalization passes by. The opportunity to take advantage of what Japan and others have offered is, in my view, wasted. Can we afford another two years of inaction? Can we afford another two years of allowing poverty to deepen?

Mr. Chairman, clearly the answer must be no. We must now begin. As someone who has spent much of his working life in the private sector, I find this inertia somewhat distressing. But Tonga, a small and vulnerable nation with few natural resources but considerable potential for growth, is ready to take on the initiative.

My friend and fellow Pacific Islander Patteson Oti from the Solomon Islands, yesterday, eloquently summarized the basic problems which his country is facing in its efforts to increase trade in goods and services. Among them, were the inadequate transport infrastructure, insufficient financial resources, and the vital importance of directly assisting the private sector. These constraints are to be found in all small Pacific island countries and there is no need for me to repeat them this morning. Suffice to note them.

And in his address yesterday, Pascal Lamy stressed 3 considerations as vital in respect of making Aid for Trade successful.

One, having a long-term national vision backed by careful design and managed strategies and policies

The second one is that of having a clear focus on financing these planned strategies and policies.

The third is securing the effective involvement of the private sector.

We from Tonga, and I'm sure representatives from the Pacific Islands, fully concur with these considerations.

As far as Tonga is concerned, it now has long-term plans for 3 specific sectors; agriculture, tourism and human resources. Labor services, with the proper skills and knowledge, are perhaps the most important sector in our economy. It is our best export and it is one that receives great attention for future development...not only for Tonga, but also for the developed countries within the perimeters of the Pacific. These are the sectors in which we have durable competitive advantage and the greatest potential for growth.

But unfortunately the issue of financing is one that hampers our development in these three sectors and the economy as a whole. This is our greatest need: having enough funds, and affordable funds, on a predictable basis for the next 3 to 5 years.

And here we look to the pledges of billions of dollars of financing made available by the WTO and for the ADB for its traditional funding of agriculture, infrastructure and skills training. Having access to a fraction of what has been pledged will go a long way to realizing the expressed goals of Aid for Trade for the small island nations. We are ready to start, and Tonga is ready to be in the forefront of this excellent initiative and I can assure the donors: we will succeed, despite some of the recently publicized adverse commentaries to the contrary.

In conclusion, I wish to reinforce the comments of WTO Director General Pascal Lamy and my colleague Patten Oti: to those decision making bodies and to those of you who hold the purse strings, please visit our countries so that the decisions you make actually reflect the realities on the ground, and allow us to effectively share in the benefits of aid for trade

KEYNOTE ADDRESS

Gloria Macapagal-Arroyo
President of the Republic of the Philippines

Thursday, September 20, 2007
Asian Development Bank Headquarters, Mandaluyong City

Keynote Address

Gloria Macapagal-Arroyo
President of the Republic of the Philippines
Thursday, September 20, 2007
Asian Development Bank Headquarters, Mandaluyong City

Welcome to the Philippines.

We are glad to witness this follow-through of Aid for Trade from its genesis in the Hong Kong WTO Ministerial Conference in 2005.

Congratulations to the Task Force that was set up after Hong Kong for its valuable recommendations of October 2006.

We are also glad to be made aware of the continuing discussions on Aid for Trade in the WTO Committee on Trade and Development in Geneva.

We continue the saga of this worthy program as we take great pleasure in having this high level Asia-Pacific Review of Aid for Trade.

Aid for Trade has rightfully brought together, and for the first time, the trade and finance communities.

This conference highlights the Asian dimension of Aid for Trade. This dimension is significant because the world is bullish on Asia and our ability to help drive positive change in the world.

In this conference, governments, donors and the private sector address specific challenges and dialogue about what is working in the region and what is not. They prioritize needs and move towards shared solutions. The discussions will result in proposals and recommendations on how Aid for Trade should proceed within Asia and the Pacific. We look forward to beneficiary countries making trade a greater priority, and aid donors scaling up trade-related official development assistance and offering their expertise. We also look forward to stronger partnerships with the private sector to develop increased private-public financing. This conference helps create an impetus for collective action.

This meeting comes at a time when the state of the Philippine economy brings hope and excitement – our growth is the highest in a generation, revenue is now on track and job creation is strong. Our deficit is down, consumer confidence is up and inflation is holding steady.

The 7.5% GDP increase in the second quarter and the 10% gain in capital investment are in line with what the Asian Development Bank says the country needs in order to replicate the poverty-eradicating growth of Asia's economic success stories.

Poverty alleviation is the number one most important part of our agenda and our vision to lift the Philippines into the ranks of the modernized nations in twenty years.

The foundation of our economic comeback is wide, deep and solid. Across the board, the nation's economy is pointed in the right direction, and for all the right reasons.

According to Biz News Asia, there are three reasons why the economy grew so strongly in the first half – spending by consumers and the government, the expansion of services, (which means telecommunications, business process outsourcing and banking), and more industrial production.

There was plenty of money in the economy; that is why consumers and government were able to spend a lot.

Overseas workers remitted dollars, which were converted into pesos, and which were funneled into the banks and used to buy housing from developers and cellular phones and e-load from stores or retailers.

The biggest single act that led to the surge in our economy was the passage of our value added tax which in one bold stroke raised enormous amounts of new revenue. We followed up the pain of tax raising measures with the gain that comes from significant investment in people and progress.

We believe in strong global engagement for our country and our people to grow our economy, ensure peace and security and lift our nation out of poverty. Figuratively speaking, the more bridges we build, the more people can cross to new lands and new ideas. We must be open to the world and peoples and places other than our own. That is what the 21st century will be about.

We believe in the power of the global trading system to alleviate poverty and modernize nations through market forces. That does not mean we believe that countries like the Philippines are ready to compete head-to-head today in every sector, but it does mean that we cannot afford to be afraid of globalization.

The multilateral trading system, through the Doha Round, remains the best option to address poverty and improve standards of living around the world through an agreed set of international trade rules. It offers a major opportunity to put in place internationally significant reforms and reductions in trade-distorting domestic support, create meaningful and substantial market access in agriculture, industrial goods and services, and introduce improved WTO rules and trade facilitation arrangements.

This conference shows that we do not overlook the fact that the Doha Development Agenda was launched with an emphasis on integrating a developmental dimension into all elements of the negotiations. WTO acknowledges the need to provide

special and differential treatment for developing members who require maximum flexibility under the international trade rules.

To make the Doha Round truly a Development Round as it is being billed: (1) there must be greater coherence or convergence of policies among international development institutions (e.g. World Bank, IMF, ADB, WTO) so that trade is mainstreamed in the development agenda and therefore capacity building can be focused and targeted and (2) we must review special and differential treatment beyond just the phasing of commitments but also capacity building and sufficient flexibility to pursue domestic development goals. Thus this conference contributes to making the Doha Round truly a Development Round.

This meeting is well timed as a global event, coming at the heels of the APEC leaders meeting in Sydney that signaled the need for breakthroughs in the WTO negotiations alongside more focused and more strategic capacity building among member economies.

The developed nations were the prime movers behind global trade when it suited them; now some countries are slowing things down. That is not right nor good for our respective economies.

There has been a ray of hope in APEC with the developed WTO members declaring that they are willing to fully adhere to the Doha mandate, in particular domestic subsidy cuts and disciplines, but they also ask to gain access to the developing world's markets.

We appreciate Pascal Lamy's visit to the Philippines last February. I told him then and I say it again: I believe it is in his hands to find the right formula of subsidy cuts and market access that will finally break the impasse.

But let me be clear: even as we work tirelessly to move the talks forward, we are not going to stand by and do nothing. For us, it is full speed ahead, preferably with Doha, but full speed nevertheless.

We recognize that fragmentation of the multilateral trading system into trading blocs will result in a more complex set of trade rules incompatible and detrimental to the interests of developing country members. But meanwhile, with a hope that there will be a successful conclusion to the Doha Round, we are maximizing the economic opportunities provided under bilateral and regional free trade agreements if only to complement efforts under the multilateral trading system.

I hope this Asia-Pacific conference ensures that WTO does not become a side-show in global affairs. Asia and the Pacific are too important and the WTO has too much promise for that to happen.

PLENARY 4

CHAIRMAN'S SUMMARY

Peter McCawley

Chair, Asian Development Fund

Visiting Fellow, Australian National University

PLENARY 4 – Donor Partnerships for AfT in Asia and the Pacific

20 September 2007, 10:50 am – 12:05 pm

ADB Auditorium Zones C and D

Session objectives:

1. To examine donor perspectives regarding the AfT initiative in Asia and the Pacific
2. To highlight views on the AfT needs of the region (including LDCs, small states and middle-income countries), identify strategic priorities and discuss prospects for increased resource mobilization
3. To discuss how best to improve mechanisms for donor-donor coordination and donor-recipient coordination on AfT programs.
4. To discuss the monitoring of AfT flows in lights of the Paris Declaration on Aid Effectiveness

Session Speakers

Moderator: Peter McCawley, Chair, Asian Development Fund, and Visiting Fellow, Australia National University

Panelists:

- Jun Yokota, Ambassador Extraordinary and Plenipotentiary, Japan
- Maureen Harrington, Vice President for Policy and International Relations, Millenium Challenge Corporation
- Alistair MacDonald, Ambassador and Head of Delegation, European Commission in Manila
- Stephen Howes, Chief Economist, Australian Agency for International Development (AusAid)
- Jinho Kim, Vice President, The Export-Import Bank of Korea
- Don Clarke, Acting Executive Director, New Zealand Agency for International Development (NZAid)
- Stefan Tangermann, Director for Food, Agriculture and Fishery of the Organisation for Economic Cooperation and Development

Chairman's Summary

Peter McCawley, Chair, Asian Development Fund and Visiting Fellow, Australia National University

OPENING: We have a panel of seven leading speakers giving donor perspectives. I'm very respectful of donors. You show me a donor and I sense politeness and awe coming on.

This is a difficult issue; the issue of financing. There is an interesting note in the booklet, Aid for Trade: How ADB Can Help. There is a key paragraph that discusses the key financial issues. (Aid for Trade, according to the WTO, comprises aid

that finances trade-related technical assistance, trade-related infrastructure and aid to develop supply-side capacity.) This definition is important, as donor funds channeled to finance, first, trade-related technical assistance, plus aid to develop new supply-side capacity, which is a rather broad definition.

There are some specific figures given. The AfT program was launched in Hong Kong and 3 figures are mentioned in the document, that most of us have seen, pledging a total of \$15 billion in new funds. Now \$15 billion is quite a lot of money; it focuses my mind when someone talks about \$15 billion. It gets my attention.

There are really two issues not specifically related to these things, but when one looks at these big figures, one issue that arises is what precisely the figures mean. The announcements are often a little vague. It is sometimes not clear whether it is grants or loans. It is sometimes not clear in the initial pledges the conditions and terms that are attached to loans, if these are loans. And it is sometimes not clear if the funds are additional. Indeed, it is sometimes hard to estimate these things if the funds are announced some years ahead.

So there are all of these issues on the supply side or the pledging side.

And then there is, secondly, the question of the use of the funds. It is sometimes difficult to track later. When we come back four, five, or six years later it's difficult to track the use of the funds.

If any of our speakers have comments on those issues it would be particularly valuable. Our speakers today would be invited to do so.

Conclusion: We discussed both the range of broad issues and some specific issues. The broad issues discussed were the overall strategies of development and, if there is one thing clear, it is that the old thinking of 20 or 25 years ago—which in some cases was inward looking development and import substituting industrialization—has passed. Virtually all voices now recognize the importance of trade for development. That is one strategic issue.

We've heard a number of comments about volume, and relating to issues of volume, a number of the speakers also raised issues of effectiveness, monitoring and evaluation, the importance of review mechanisms both for implementation inside donor countries, and as one speaker put it, how the donors themselves are following up on their commitments.

Several of the speakers referred to studies or evaluations of Aid for Trade programs, some of which, it was mentioned, need to be improved upon. And related to that (greater) effectiveness was the issue of transparency.

Then there was a range of issues which I will only just list:

- harmonization attracted attention of some speakers and the difficulty of harmonization under some circumstances. One of our colleagues said that the reality

- of harmonization on the ground sometimes does not match the fine words
- conditionality was mentioned
- additionality was discussed and a number of our speakers outlined a range of different ways that assistance is being delivered in this area.

One of the phrases, which I thought was a nice categorization: aid for trade is being delivered beyond the border, at the border, and behind the border. A number, if not even all, mentioned the importance of infrastructure to promoting trade across the region.

CLOSING REMARKS

Pascal Lamy
Director-General, World Trade Organization (WTO)

Wednesday, September 19, 2007
Asian Development Bank Headquarters, Mandaluyong City

Closing Remarks

Pascal Lamy

Director-General, World Trade Organization (WTO)

Thursday, September 20, 2007

Asian Development Bank Headquarters, Mandaluyong City

I expressed the hope yesterday that this vibrant country would inspire us. My hopes have been exceeded.

We heard that there are two Asias — one that has harnessed globalization for extraordinary growth and another that wants to catch up. We heard that these countries understand the opportunities and challenges — that they are ready and willing to embrace them — but that in key areas they need international support. And we heard that trade liberalization is only one half of the equation. The Doha Round is about creating trade opportunities. Aid for Trade is about making trade happen.

Above all, we heard the start of a real dialogue — between finance and trade, between trade and development, between business and governments, between countries and regions — about where exactly the challenges lie and how we should work together to answer them.

I want to take a moment to highlight some of the key messages I will be taking away from the last day and a half:

First, leadership. Asia's trade powerhouses were no accident. The key element of their success was political leadership — a focused and sustained commitment to export-led growth — backed by a comprehensive strategy for getting there. The message we've heard over the last day and a half is that trade must be mainstreamed in all facets of national policy if countries are going to harness globalization for their benefit.

Having a clear strategy - backed by government as a whole and the private sector - is also one part of the answer to coordinating donors. It is how to ensure that donors respond to national priorities, not the other way around. This is real "ownership".

Second, priorities. Countries and regions have to focus on what matters most to increasing exports — and the areas that can deliver the biggest return on investment. To have a fifty priorities is to have no priorities. The challenge for many countries in the region — and it is a big one both substantively and politically — is to agree on the two or three objectives that will impact most on their trade growth - and then pursue them consistently over the long term.

Third, predictability and accessibility of financing. There is a clear need for donors to follow through on their Hong Kong and broader Gleneagles commitments — and we should focus on how we deliver on these promises, rather than second guessing them. At the same time, efficiency and effectiveness in the delivery of financing can be just as important as the amounts involved — especially in a fast changing global economy. Donors and financial institutions need

to show progress on this front as well — by reducing red tape and fast-tracking disbursement. This is a critical issue for recipient countries. It is also an issue for taxpayers at home who want to see their money producing tangible development results.

Fourth, co-operation. The reality is that no one agency can deliver Aid for Trade single-handedly. We have learned that where there are capacity “gaps” in the region they often result from a breakdown of cooperation and coherence, not just a lack of resources. Governments need to coordinate internally. Donors and financial institutions need to coordinate with each other and with governments. Countries need to coordinate regionally.

Finally, the key role of the private sector. We not only need to listen to traders, investors and entrepreneurs, but bring them into the conversation - as we have done over the last day and a half. Aid for Trade will be relevant if it is “market driven”. It risks irrelevance if it becomes a dialogue among bureaucrats.

As I mentioned yesterday, the plan now is to produce a concise report of this meeting — under the responsibility of the ADB and the WTO — which will be the transmission belt for your ideas, conclusions and recommendations at the Global Review in Geneva in November.

My view is that the report should be action-oriented — shifting gears from a discussion of concepts, which has been necessary up to now, to a discussion of specific proposals aimed at concrete results. First, we need to identify two or three key priorities for the region — ones that will give us a clear set of objectives to aim for over the medium term, and against which we can measure our success. For example, I have heard a lot about the need to concentrate on trade financing, trade facilitation, and trade-related infrastructure. Second, we need to set out a clear timetable - for mapping priorities, mobilizing financing, and implementing projects. Third, we need to identify a mechanism for bringing together the key regional stakeholders and for moving the process forward. I believe the ADB is ideally placed to play this catalytic role.

This report cannot — and should not — provide all the answers now, but it should ask the right questions — with a view to making a start on addressing them in Geneva in November.

We need to deliver results — without at the same time raising unrealistic expectations. We need to provide an Aid-for-Trade plan that is relevant to this region, fills “gaps”, and sets out ambitious but also realizable and specific objectives. Above all, we need to show that the world trading system can — and will — deliver more benefits for those who are still on the margins. That is why the current WTO Round has development as its central pillar — and why progress in the Round is so critical for Asia and the world. Aid for Trade — I repeat — is no substitute for a successful Doha Development Round. It is also no substitute for the right domestic policies. But Aid for Trade is an increasingly important and necessary complement.

This meeting has taken a big step forward. The Philippines has inspired us. Let's keep up the momentum.

CLOSING REMARKS

Haruhiko Kuroda
President, Asian Development Bank

Thursday, September 20, 2007
Asian Development Bank Headquarters, Mandaluyong City

Closing Remarks

Haruhiko Kuroda
President, Asian Development Bank
Thursday, September 20, 2007
Asian Development Bank Headquarters, Mandaluyong City

Your Excellency Prime Minister Sevele, Director-General Lamy, Secretary-General Supachai, Honorable Ministers, distinguished guests, ladies and gentlemen:

Thank you all for participating in what I believe have been extremely fruitful discussions on how to mobilize Aid for Trade in Asia and the Pacific. I think the networking that has been done outside the formal sessions has been equally worthwhile, allowing us to share experiences on what may work as the Aid for Trade initiative moves into its next stage. I am particularly grateful to President Macapagal-Arroyo, the Philippine Department of Trade and Industry, and World Trade Organization Director-General Lamy for their invaluable contributions.

It is important to remember that Aid for Trade can not be a substitute for the Doha Round, but is a complement to what we hope will be a successful completion of the negotiations. We have learned a great deal in a short time. There are six main themes that have come out of this review meeting. First, we are reminded of the diverse needs of Asia and the Pacific in Aid for Trade. At the extremes are the land-locked economies where goods must cross many borders to reach markets, and the isolated small states with limited productive capacity. In between lie economies with notable potential but large challenges in infrastructure, policy and capacity. It is clear that an appropriate Aid for Trade strategy in our region must be tailored to meet the specific needs of our diverse developing member countries.

Second, the success stories in Asia and the Pacific offer many lessons as Aid for Trade moves forward. These include the importance of keeping outward-orientation as an integral part of national development strategies, building world-class infrastructure to support cost-competitive production and services, and creating the critical mass of general and technical skills needed for trade-related development.

Third, the region needs effective public-private partnerships to drive innovative trade finance. As the region's capital markets deepen, lending and credit enhancements, including guarantees, can reduce trade costs---particularly for export credits and risk protection. Of course, public-private sector partnerships are important in diagnosing, delivering, and monitoring Aid for Trade programs more generally.

Fourth, the range of participants at this meeting illustrates the usefulness of bringing together all key actors in Aid for Trade---whether they be trade and finance ministers, recipients and donors, or private sector or others.

Fifth, I am encouraged that the major donors have shown the willingness to commit

additional resources for Aid for Trade in the region. And I am glad to hear that some of these new funds are already being converted into concrete aid programs.

And finally, it is worth reiterating that the Aid for Trade initiative is in fact “Aid for Trade for Development,” and not Aid for Trade per se. We therefore need to ensure that this initiative is firmly grounded in the region’s development agenda, and in support of ADB’s overarching goal of poverty reduction.

ADB can be effective as Aid for Trade moves forward in advocacy, implementation, and monitoring. We look forward to working with our global and regional development partners to ensure Aid for Trade is a success. The outcome of this review meeting will be reflected in our joint report to the Global Aid for Trade Review meeting in Geneva.

In closing, I want to thank you all once again for participating and wish you a safe journey home.

Thank you.

Appendix

Background Paper on the Greater Mekong Subregion

Appendix 1

Prepared by the Southeast Asia Department of the Asian Development Bank
September 2007

ABBREVIATIONS

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
CASP	Core Agricultural Support Program
CBTA	Cross-Border Transport Agreement
CEPT	Common Effective Preferential Tariff
CPI	Committee for Planning and Investment
CDRI	Cambodia Development Resource Institute CIEM Central Institute for Economic Management CLV Cambodia, Lao PDR, Viet Nam
DAN	Development Analysis Network
EU	European Union
FDI	foreign direct investment
FIEs	foreign-invested enterprises
FTA	free trade area/agreement GDP gross domestic product
GMS	Greater Mekong Subregion
GSP	General System of Preferences
Guangxi Zhuang AR	Guangxi Zhuang Autonomous Region, PRC IL Inclusion List
Lao PDR	Lao People's Democratic Republic
MFN	Most-favored nation
MoP	Margin of preference
MPI	Ministry of Planning and Investment
NERI	National Economic Research Institute
NSC	National Statistics Center
NTR	Normal trade relations
PRC	People's Republic of China
RCA	Revealed comparative advantage
SFA-TFI	Strategic Framework for Action on Trade Facilitation and Investment
SOEs	state-owned enterprises
SPS	Sanitary and phytosanitary
UN	United Nations
UN COMTRADE	United Nations Commodity Trade database
UNDP	United Nations Development Program
WTO	World Trade Organization

NOTES: In this report, "\$" refers to US dollars.



EXECUTIVE SUMMARY

The Greater Mekong Subregion (GMS) economies¹ have grown impressively over the last decade and a half as many of them started the process of transition from centrally-planned to market-based systems and forged closer integration with external markets. Strong rates of economic growth have been fueled in part by increased trade orientation. Enhancing trade further is an important element of the development strategies of the GMS economies.

This paper outlines the trends and patterns of merchandise trade of the GMS economies. It discusses tariff and nontariff barriers, as well as supply-side constraints to trade in Cambodia, Lao People's Democratic Republic, and Viet Nam (CLV). A lack of information precludes an equal focus on Myanmar, as well as Guangxi Zhuang Autonomous Region and Yunnan Province of the People's Republic of China (PRC). Thailand and the PRC are included primarily as reference points. The paper concludes with some policy implications.

Exports from the seven GMS economies, based on recorded trade flows, rose from \$37 billion in 1992 to \$154 billion in 2005, or at a compound average annual rate of 11.6%, compared with an 8.4% rise in world exports. Export growth was particularly strong in Cambodia and Viet Nam. A number of factors contributed to the successful performance, including unilateral reforms to liberalize trade and investment, rehabilitation and improvement of infrastructure and institutions, and greater market access in regional and developed country markets.

The increase in GMS countries' trade has been accompanied by a marked change in the commodity structure of exports. The structure has evolved according to each country's comparative advantage. GMS countries are generally rich in agricultural and natural resources and, with its low-cost labor, possess a competitive edge in labor-intensive manufactured goods.

This shift in export structure is evident in all the countries, but it is particularly large in Cambodia, where clothing exports benefited from earlier access to developed country markets and now comprise close to 90% of total exports. Manufactured products from the Lao PDR and Viet Nam have also risen significantly, comprising more than half of total exports. Primary products remain important in these countries. Clothing exports comprise about 80% of the Lao PDR's manufactured exports, mostly destined to the EU. Viet Nam's manufactured exports are also dominated by light consumer goods, but they are more diversified. Apart from clothing and footwear, processed food, wood products, leather goods and, significantly, machinery and equipment have gained in importance.

GMS countries' trade expanded rapidly both within the subregion and with the outside

¹ The GMS countries comprise Cambodia, People's Republic of China (PRC), Lao People's Democratic Republic (Lao PDR), Myanmar, Thailand, and Viet Nam. Cambodia, Lao PDR, Myanmar, Thailand, Viet Nam, Yunnan Province of PRC, and Guangxi Zhuang Autonomous Region of PRC participate in the GMS Economic Cooperation Program. This report refers to participants in the GMS Economic Cooperation Program as GMS economies.

world over the last decade reflecting their broad outward-oriented strategies. Excluding the PRC, intra-GMS exports rose at an annual average rate of 19% during 1994–2006, while their exports to other countries increased at an annual average rate of 11%. The rise in exports to the PRC was faster at an average annual rate of 22%. Exports to non-GMS members of the ASEAN Free Trade Area (AFTA)—Indonesia, Malaysia, Philippines, and Singapore—and to “other East Asia” (Hong Kong, China; Republic of Korea; and Japan) each rose 9% annually on average, while those to the rest of the world (primarily the United States and EU) increased at the same rate as exports to the world.

CLV countries show marked differences in the evolution of their trade shares. The share of Cambodia’s trade with other GMS countries (excluding the PRC), and with non-GMS AFTA countries fell sharply over the last decade with its specialization in garments, most of which are sold in the United States and, to a lesser extent, the EU.

The Lao PDR is the most dependent on the GMS for its trade, partly reflecting its landlocked geography and relatively greater remoteness from major markets. However, as the country becomes more linked with regional and global economies with improvements in cross-border infrastructure and greater market access, its export dependence on the subregion is declining.

Viet Nam’s trade share with other GMS countries excluding PRC rose modestly over the last decade. The PRC is increasing in importance to Viet Nam as an export market and as a source of imports. As access to markets in the EU and the United States increased, their share in Viet Nam’s exports also rose. The share of trade with non-GMS AFTA and other East Asian economies declined over the last decade, but they remain important trading partners, especially as a source of imports.

The opportunities for enhancing trade further are large. First, CLV countries are located close to the rapidly-growing markets in the PRC and India, suggesting strong potential demand for their products. Second, with a relative abundance of agricultural resources, CLV countries stand to benefit from the globalization of processed food markets. With the agriculture sector accounting for 50–70% of employment in CLV countries, growth in production and exports from this sector will be necessary to improve incomes and reduce poverty.

Third, the ongoing process of product fragmentation and the growing importance of East Asia in the manufacture and assembly of components also suggest that newcomers to export-led industrialization, such as CLV countries, will have increased opportunities for export expansion. Fourth, market access has continued to improve in recent years both in ASEAN and in developed countries outside the region, for example, with the Lao PDR’s normal trade relations (NTR) status in the United States since 2005, and Viet Nam’s WTO membership in 2007. ASEAN’s ongoing efforts to forge closer economic partnerships with major markets in the region, including PRC, India, Japan, and Korea among others, are likely to promote CLV countries’ access further. Finally, in spite of the rapid growth of exports in the past, CLV countries’ share of world markets for most commodities remains small, indicating substantial scope for increasing exports without adversely affecting their terms of trade.

In spite of CLV countries' strong trade performance, however, the export base is narrow, especially in Cambodia. This increases their vulnerability to swings in external demand for the narrow range of products at a time when competitive pressures from increased integration are likely to increase. The potential for agro-based exports, for example, has not been realized. Cambodia's advantage in primary products has generally eroded over the years, largely reflecting its specialization in garment exports. The revealed comparative advantage (RCA) indices for wood, cotton, fresh fish, wood products, crude rubber, and rice, for example, have eroded over the last decade, although the country retains a (marginal) advantage in the last three commodities. Comparative advantage in clothing, footwear, processed fish, and some textile materials has increased notably over the period.

The Lao PDR shows an increase in comparative advantage in a number of agricultural and natural-resource products, including cereals, vegetables, crude rubber, coffee, spices, silk, jute, copper, zinc, and electric energy. Its comparative advantage in wood and wood products, which has eroded in the past decade, remains significant. Among manufactured products, the comparative advantage in clothing remains dominant, while that in footwear has increased modestly.

Viet Nam possesses an advantage in a larger number of agro-based products, such as fresh and processed fish, rice, fresh fruit and nuts, coffee, tea, and spices, among others. Within manufacturing, apart from clothing and footwear, Viet Nam's advantage lies in leather products, wood products, and it has gained advantage over the last decade in others, including pottery, cutlery, furniture, and notably, some machinery and equipment. It retains a (smaller) advantage in crude and refined oil products than it did a decade ago.

The observed comparative advantage and its evolution over time depend on a number of factors in addition to differences in resource endowments. These include trade policy (tariff and nontariff barriers), technology, geography (a country's proximity to large markets and access to navigable waters), quality of institutions and infrastructure, the level of education and knowledge of its workers, among others. Some of these determinants, such as climate and the availability of arable land, are relatively fixed while others, such as the level of education and skills of the workforce, the quality of infrastructure and institutions, and technology, evolve over time, either because of government policy or because of feedback effects as a country develops. As these determinants change over time, a country's comparative advantage changes and so does its pattern of trade.

A potential increase in competitive pressures both from within the subregion and from other developing countries underscores the need to further reduce impediments to trade, improve the general business environment, and raise overall economic competitiveness. These measures will be especially important for Cambodia and the Lao PDR to diversify their economic structures in order to mitigate vulnerabilities to swings in external demand. Unleashing the export potential of CLV countries will require further progress in rationalizing tariff and nontariff (e.g., quotas, licensing) barriers, in measures to facilitate trade and transport, in efforts to relieve constraints on private sector development, and in developing the capacity to meet international food safety standards, while maintaining macroeconomic stability.

Despite the reduction in tariff rates over the last decade and a half, there is scope for further progress in rationalizing trade policy. In the Lao PDR, for example, even with the substantial improvement in trade policy over the years, licensing requirements for imports and exports remain cumbersome. Furthermore, although CLV countries' average tariff rates have fallen, they follow a cascading structure, with the tariff rate escalating with the degree of processing of a product. This increases the effective protection on final goods produced for the domestic market at the expense of exports. The margin of preference given to imports from ASEAN relative to those from other countries is also relatively high for Viet Nam, indicating some risk of trade diversion and deflection. A more uniform tariff rate across products and trading partners would reduce the anti-export bias, mitigate any risk of trade diversion, and potentially increase administrative efficiency.

Other trade costs arising from regulatory burden, inadequate infrastructure, and generally inefficient customs procedures and logistics of moving goods across borders have become relatively more significant as tariff and quantitative restrictions on trade have been progressively reduced. Poor transport and logistics networks not only raise the direct costs of freight and storage but impose substantial costs from delays in transit time. The cost of transit delays is particularly high for time-sensitive goods, such as perishable agricultural products and seasonal or fashion apparel. These are some of the products in which CLV countries have a comparative advantage. As countries specialize in particular stages of production in a regional or global supply chain, improved quality of transport infrastructure becomes even more important. The frequent need to import intermediate goods for processing for reexport will require a reliable transport and logistics network.

The data suggest that, although CLV countries made substantial progress in the past decade and a half in rehabilitating social and physical infrastructure, there is a substantial need to increase the amount and efficiency of investments in these areas, especially in Cambodia and in the Lao PDR. While Viet Nam's indicators appear better than those of an average low-income country, improved delivery of social and physical infrastructure services will be necessary as it moves toward middle-income status over the medium term.

The cost to trade across borders is relatively high for CLV countries, particularly the Lao PDR, reflecting its landlocked geography, greater remoteness from major markets, and rugged terrain. The transit time is also high. Most of the time in GMS countries is spent on preparation of documents. However, the time required in CLV countries for document preparation is significantly higher than in the PRC and Thailand. The time required in the Lao PDR is particularly high, partly reflecting elaborate licensing and approval procedures for imports and exports, in addition to its geography.

Apart from these impediments to trade, other constraints on the domestic investment environment can impose heavy costs on businesses, damping their ability to compete in international markets. Investment climate surveys conducted by the Asian Development Bank (ADB) and the World Bank suggest that in Cambodia, businesses perceive broad governance issues, including corruption, crime, legal, and regulatory uncertainty, as the main constraints. In the Lao PDR, deficient infrastructure, regulatory uncertainty, and access to finance are listed as the main obstacles. Firms in Viet Nam identify inadequate

access to land, insufficient access to finance, and deficient infrastructure as the main obstacles. These constraints are perceived to be higher by firms in Cambodia, Lao PDR, and Viet Nam, respectively, than by similar businesses in either East Asia or other developing countries.

Relieving these constraints would reduce the costs of doing business, increase predictability of the policy environment, and help increase private sector investment. In Cambodia, this will require quicker implementation of policies to simplify regulations, improve enforcement, and reduce administrative discretion. In the Lao PDR, provision of infrastructure, cited by businesses as the main constraint, will require policies to encourage participation of private investors, especially foreign ones. Raising public investment in infrastructure will also require further progress on fiscal reforms in order to raise sufficient revenues to meet financing requirements. In the Lao PDR and Viet Nam, the constraints also underscore the importance of ongoing reforms to restructure state-owned banks, which are dominant in the provision of finance, with the aim of ultimately privatizing them. In Viet Nam, access to land will depend on developing markets for land-use rights, which can then be used as collateral by companies. Much of the commercial property is owned by SOEs. The equitization of SOEs, restructuring and equitizing state-owned commercial banks, nurturing healthy capital markets, and developing a sound regulatory environment for private sector participation in infrastructure are key reform priorities.

Meeting product quality standards to take advantage of the potential for agricultural and other exports will also require concerted efforts to develop necessary regulation and domestic capacity. CLV countries have gradually begun to develop capacity with the assistance of development partners. Regional cooperation could also aid in this process. Thailand, for example, has a proven track record in meeting sanitary and phytosanitary (SPS) standards for processed food exports and in resolving SPS-related trade disputes. It, thus, has the potential to assist CLV countries in building their institutional capabilities to meet international food-safety standards.

CLV countries are aware of the challenges to sustain and improve upon their successful record in enhancing trade and growth, as reflected in their medium-term development plans. Improving the overall climate for trade and investment will require financial as well as technical assistance to explore international good practice in regulatory reform and adapt it to local circumstances; build capacity of government agencies; and help countries comply with commitments under AFTA, WTO, and other agreements.

Multilateral and bilateral organizations have been supporting the governments' efforts to better the environment for trade and investment. Under the GMS Economic Cooperation Program, for example, assistance from multilateral and bilateral agencies has led to greater connectivity among the GMS countries. The focus of cooperation has expanded to include more efficient customs and logistics as well as capacity development.

Tables A1.1 and A1.2 in the Appendix of this report provide an indicative pipeline of lending and technical assistance projects proposed to be supported by ADB, in cooperation with other development partners, under the GMS Economic Cooperation Program over the next 3 years. Many of these projects directly support trade-related infrastructure and capacity development in the GMS. The requirements for such assistance are large.

The pipeline of projects comprises a portion of the priority projects identified by nine sector working groups of the GMS program. It is also complementary to the national programs of each GMS country, many of which are supported by other development partners, as well as by ADB.

I. INTRODUCTION

The Greater Mekong Subregion (GMS) economies¹ have grown impressively over the last decade and a half as many of them started the process of transition from centrally-planned to market-based systems and forged closer integration with external markets (Table 1). The seven GMS economies grew 8.3% per year on average during 1992-2006. All the economies, except Thailand, expanded at an average annual rate of at least 6.5%. Thailand's growth was held back primarily by the effects of the 1997–1998 financial crisis.

Strong rates of economic growth have been fueled in part by increased trade orientation. Enhancing trade further is an important element of the development strategies of the GMS economies.² Policies to enhance trade, set within a broad reform agenda, can further promote growth and reduce poverty. Trade leads to greater specialization in accordance with a country's comparative advantage and a more efficient allocation of scarce economic resources. It enlarges the market for products and enables domestic producers to benefit from economies of scale. Importantly, trade increases productivity growth and welfare by enhancing competition, raising foreign direct investment (FDI), and providing access to new products and ideas.

Table 1: Selected Economic Indicators

Country	GDP growth (Annual Ave, 1992–2006,%)	GDP (\$ million) 2006	Population (million) 2006	GDP per capita (\$) 2006
Cambodia	8.4	7,264	14.2	513
Guangxi Zhuang AR, PRC	11.7	50,190	49.4	1,015
Yunnan Province, PRC	9.5	60,224	44.7	1,348
Lao PDR	6.5	3,433	5.7	599
Myanmar	9.6	13,002	56.2	231
Thailand	4.5	206,247	65.2	3,162
Viet Nam	7.7	60,883	84.2	723
GMS Economies	8.3	401,245	319.6	1,255
PRC	10.3	2,626,304	1,311.0	2,003

¹ The GMS countries comprise Cambodia, People's Republic of China (PRC), Lao People's Democratic Republic (Lao PDR), Myanmar, Thailand, and Viet Nam. Cambodia, Lao PDR, Myanmar, Thailand, Viet Nam, Yunnan Province of PRC, and Guangxi Zhuang Autonomous Region of PRC participate in the GMS Economic Cooperation Program. This report refers to participants in the GMS Economic Cooperation program as GMS economies.

² For example, the medium-term development plans for 2006–2010 of Cambodia, Lao PDR, and Viet Nam list increased trade and integration with external markets as a key strategy to achieve their development objectives. See Royal Government of Cambodia (RGC), 2006, pp. 50, 66; Committee for Planning and Investment (CPI), 2006, pp. 55–59; Ministry for Planning and Investment (MPI), 2006, pp.77–81.

GDP = gross domestic product, PRC = People's Republic of China, Guangxi Zhuang AR = Guangxi Zhuang Autonomous Region, Lao PDR = Lao People's Democratic Republic.

Sources: Asian Development Bank. Statistical Database System (SDBS) Key Indicator Series, downloaded 25 July 2007; National Bureau of Statistics of China. China Statistical Yearbook. IMF World Autonomous Region, Lao PDR = Lao People's Democratic Republic.

Sources: Asian Development Bank. Statistical Database System (SDBS) Key Indicator Series, downloaded 25 July 2007; National Bureau of Statistics of China. China Statistical Yearbook. IMF World Economic Outlook database, April 2007 for Myanmar's GDP (estimate for 2006 based on actual data for 2003).

This paper outlines the trends and patterns of merchandise trade of the GMS economies. It discusses tariff and nontariff barriers, as well as supply-side constraints to trade in Cambodia, Lao People's Democratic Republic [Lao PDR], and Viet Nam (CLV). A lack of information precludes an equal focus on Myanmar, as well as Guangxi Zhuang Autonomous Region (Guangxi Zhuang AR) and Yunnan Province of the PRC. Thailand and the PRC are included primarily as reference points. The paper concludes with some policy implications.

II. TRENDS IN TRADE

Exports from the seven GMS economies rose from \$37 billion in 1992 to \$154 billion in 2005, or at a compound average annual rate of 11.6%, compared with an 8.4% rise in world exports (Figure 1a). Among the individual economies, average annual export growth during the period ranged from 9% in Guangxi Zhuang AR, PRC to 22% in Viet Nam (Figures 1b–1h). Export growth of Cambodia was also fast at an average annual rate of 21%. These trends are based on recorded trade flows. The GMS economies engage in a substantial amount of informal trade among themselves (Box 1). One estimate puts the volume of informal (unrecorded) trade at 20–30% of total cross-border trade in the region (DAN 2005, p.12; see also ADB 2006e, Chapter 4).

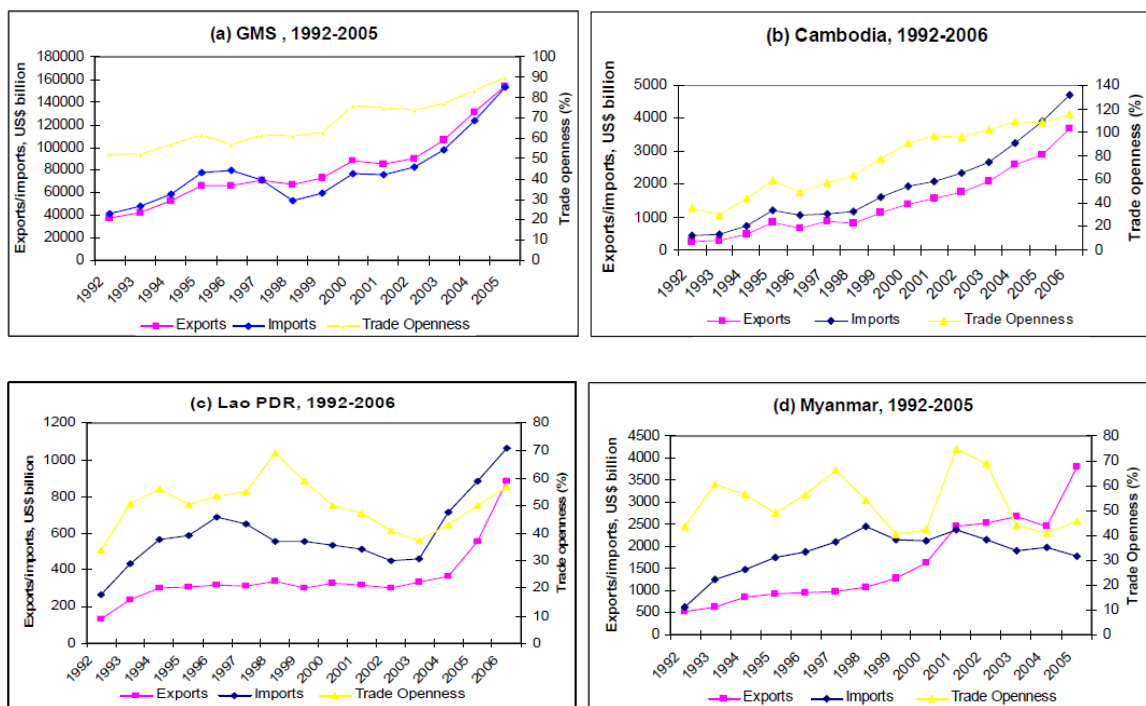
A number of factors contributed to the successful trade performance. As many of these economies began the process of transition to market-based systems in the latter half of the 1980s, the dominance of state-owned enterprises (SOEs) was reduced; prices and trade of goods and services were liberalized; and restrictions on the private sector were eased.

Cambodia, for example, abolished the state monopoly for foreign trade in 1987 and allowed the private sector to engage in foreign trade in 1989. The reform program accelerated following national elections and the establishment of a democratic government in 1993. Notwithstanding some setbacks in the mid-1990s brought about by political instability, the country achieved notable success in revamping and stabilizing its war-ravaged economy with greater outward orientation. Quantitative restrictions on trade were largely abolished in the mid-1990s, and import tariffs were streamlined over the years to a four-band structure (0, 7%, 15%, and 35%) by 2002.

In the Lao PDR, tariffs have been substantially lowered since the process of economic liberalization commenced, with a major reduction in 1995 when a complex multiple tariff rate system with a 150% maximum rate was replaced by a simpler six-band structure (5%, 10%, 15%, 20%, 30%, and 40%). However, all imports are still subject to some form of licensing. Importers have to submit an annual business plan to the provincial trade unit and the One Stop Service 6 months or a year in advance in order to obtain licenses.¹ Imports of some goods, such as petroleum and gas, vehicles and spare parts, cement, and steel, require special permission from the Ministry of Industry and Commerce. A number of other products, such as processed foodstuffs, seeds and breeding animals, consumer electronic goods, and chemicals and mineral products, require permits from several other agencies.

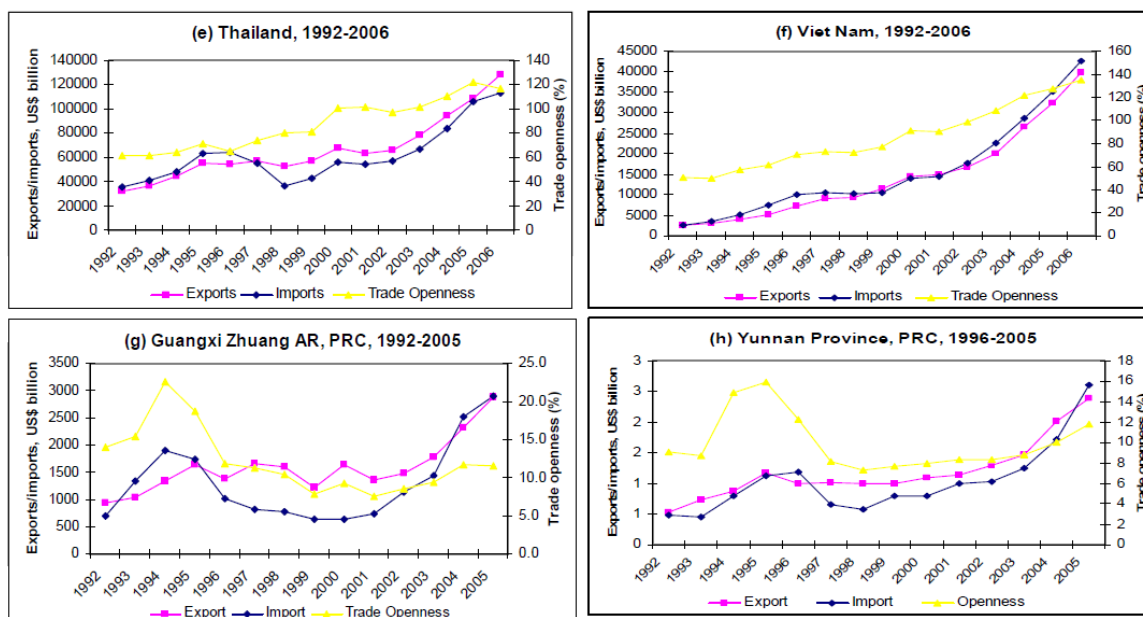
Viet Nam's enactment of the Law on Import and Export Duties in 1988 marked the beginning of trade reforms. The original import tariff schedule was replaced in 1992 by a detailed, consolidated schedule based on the Harmonized System of tariff nomenclature. The tariff structure was fine-tuned in subsequent years, and the maximum tariff rate was reduced from 200% in 1997 to 113% in 2004. As of October 2005, less than 1% of total tariff lines, accounting for about 4% of import value, had tariff rates above 50%. Quantitative restrictions have largely been abolished with a conversion to tariff rate quotas on some products.²

Figure 1: Exports, Imports, and Trade Openness



¹ See CPI/NSC/UNDP 2006.

² Under a tariff rate quota, imports below a specified quantity enter at a low (or zero) tariff and imports above that quantity enter at a higher tariff.



Notes:

1. GMS includes Cambodia, Yunnan Province and Guangxi Zhuang AR of PRC, Lao PDR, Myanmar, Thailand, and Viet Nam.

2. Openness ratio is defined as the ratio of total trade (exports + imports) to GDP.

Sources: Asian Development Bank. Statistical Database System (SDBS) Key Indicator Series, downloaded 25 July 2007; National Bureau of Statistics of China. *China Statistical Yearbook, various issues*, IMF World Economic Outlook database, April 2007 for Myanmar's GDP.

Private sector development and encouragement of FDI have been important elements of the market-oriented strategies of CLV countries. Policies toward FDI have become progressively liberal over the last 15 years although administrative inefficiencies remain. Full foreign ownership is allowed in most industries. Major reforms have been legislated to provide equal treatment of foreign and domestic investors and to streamline procedures for approval and registration.

Memberships of the Association of Southeast Asian Nations (ASEAN) and the World Trade Organization (WTO) have aided the reform momentum and increased GMS countries' access to external markets.¹ Cambodia became a member of the ASEAN in 1999, the Lao PDR in 1997, and Myanmar and Viet Nam in 1995. More recently, Cambodia became a

¹ Under the Common Effective Preferential Tariff (CEPT) scheme of the ASEAN Free Trade Area (AFTA), Viet Nam was scheduled to reduce the tariff rate on the items in its Inclusion List (IL) to 0–5% by 2006; Lao PDR and Myanmar by 2008; and Cambodia by 2010. All tariff preferences are expected to be reduced to zero by 2010 in the six original members and by 2015 in the four GMS countries.

Box 1. Cross-Border Trade in GMS

The long and porous borders of GMS economies make it difficult to estimate precisely the volume of cross-border trade. For landlocked Lao PDR, cross-border trade is synonymous with its trade with neighboring countries. Based on recorded trade flows, more than 60% of the Lao PDR's trade occurs with other GMS countries and, hence, can be considered cross-border trade. In Cambodia, more than 90% of total imports from Thailand are cross-border. Viet Nam's cross-border trade with the PRC, Cambodia, Thailand, and Lao PDR is believed to account for about 20% of its total imports and 10% of its total exports.

Informal (unrecorded) trade seems to account for a significant share of cross-border trade in the region. According to a recent study based on field surveys conducted in selected border provinces in Cambodia, Lao PDR, Viet Nam, and Thailand, informal trade could account for 20–30% of total cross-border trade in the region (DAN 2005, p. 12). This share varies significantly among the countries and among different product categories.

Informal cross-border trade is carried out predominantly by small traders, who operate individually or as agents/subcontractors to larger traders. As elsewhere in the world, informal trade in the GMS thrives on personal links and 'trust', based on repeated transactions that have substituted for missing institutions in business financing, law enforcement, and insurance. Informal traders mostly deal in consumer goods, such as cigarettes, electronics, and electrical goods, which are banned or come under high-duty brackets in official tariff schedules. They operate through both formal (international) and informal border crossings and trade in local markets, mostly within the border area.

A number of factors contribute to informal trade. Poor transport facilities and lack of understanding of formal trading practice place producers and consumers in remote areas at the mercy of informal traders. High and variable import duties and various other restrictions on imports and exports have the unintended consequence of dissuading traders from the use of formal channels. The costs of complying with regulations and corruption at formal border check points also provide strong incentives for traders to look for informal trade routes. These factors suggest that low and more uniform tariffs; better enforcement of streamlined regulations; and efficient, transparent, and predictable customs procedures would ease the burden on small traders and reduce their incentives to skirt formal channels of trade.

member of WTO in 2004. Viet Nam became a member in 2007, and the Lao PDR has begun bilateral negotiations for WTO accession.¹

Several bilateral agreements with developed countries, especially the United States and the European Union (EU), have also propelled the growth of trade. Cambodia received most-favored nation (MFN) treatment on its exports to the United States in 1996; the Lao PDR received MFN status in the United States in 2005, and Viet Nam in 2001. Cambodia, Lao PDR, and Viet Nam were eligible for General System of Preferences (GSP) in the 1990s and, more recently, the Everything-But-Arms initiative of the EU, as well as GSP treatment from other countries, such as Japan.

FDI has been a major conduit for growth of trade with the easing of restrictions. In Cambodia, for example, FDI from Northeast Asia (primarily Republic of Korea; Taipei, China; and more recently, the PRC) helped propel garment exports. The shift to Cambodia by investors from Taipei, China and Republic of Korea reflects partly the eroding competitiveness of garment production with rising wages. In the case of the PRC, by shifting location to Cambodia, investors were able to bypass the quotas in the main markets on garment imports from the PRC. In the Lao PDR, FDI in agriculture and forestry and, more recently, in mining and hydropower projects has been a key contributor to export growth.

¹ Myanmar has been a member of WTO since 1995.

In Viet Nam, FDI was initially concentrated in the extraction of crude petroleum and gas. But the share of manufacturing has increased over the last decade. Viet Nam is becoming gradually linked to regional production chains, reflected in the notable structural shift in export composition toward assembled electrical and electronic products. Foreign-invested enterprises (FIEs) are driving this process. Many of these FIEs so far have been small- and medium-scale assembly plants with few exceptions, such as Fujitsu and Hitachi. The decision last year by Intel to invest \$1 billion in a chip assembly and testing factory has provided a significant boost to the industry. FIEs are also driving exports in other key products, such as footwear and garments. Overall, they accounted for 44% of total non-oil merchandise exports in 2005, up from 3% in 1991 (ADB 2006d, p. 35). These factors contributed to a steady rise in external trade of the GMS economies until about the mid-1990s, when the rate of expansion slowed, somewhat reflecting adverse effects of the East Asian financial crisis. The slump in the global information and communications technology sector in 2001 and the consequent economic slowdown in East Asia also contributed to a pause in overall trade growth. In recent years, trade has again expanded strongly. Regional markets have recovered, the PRC's role as a locomotive for trade has increased, global prices of commodity exports have risen, and CLV countries' efforts to liberalize trade further and to improve their business environment have continued, partly with the continued impetus from various agreements to enhance trade and economic cooperation.

The trend in trade for the seven GMS economies in aggregate largely reflects the trend for Thailand, the largest trader among them. Thailand's export value is, by far, the largest, although its share of exports from the subregion's seven economies declined to 71% in 2005 from 87% at the beginning of the 1990s, with a corresponding rise in Viet Nam's share from 7% to 21% during the period. With rapid export growth, Cambodia's share also more than doubled during the period. The Lao PDR's trade growth has been more erratic, largely attributable to its trade dependence on Thailand, which faced a crisis in 1997–1998, and its own macroeconomic instability during the period. Following a successful stabilization program launched in 1999, the Lao PDR's export growth accelerated and by 2006, it was higher than the regional average, reflecting in part a sharp increase in mineral exports. Myanmar's exports rose until 2001, but have generally stagnated since then, reflecting policy slippages and restrictions on access to developed country markets. In 2005, Myanmar's exports picked up sharply partly on higher prices for natural gas. External trade constitutes a relatively small proportion of the economies of Yunnan Province and Guangxi Zhuang AR of PRC, reflecting their naturally tighter trade linkages with the wider PRC economy. However, exports from these regions have also grown rapidly in recent years, albeit at a slower rate compared to that for the whole of PRC.

The degree of openness to trade, measured by the ratio of trade (exports and imports) to gross domestic product (GDP) has increased in most economies during 1992–2006. The increase is especially sharp for Viet Nam and Cambodia. Thailand's openness ratio also rose sharply as its economy contracted following the onset of the 1997 financial crisis in contrast to a greater resilience in exports. The external trade orientation of Guangxi Zhuang AR and Yunnan Province of PRC rose in recent years, but it is modest in comparison to that of PRC as a whole, whose openness ratio increased from 27% in 1992 to 66% in 2006. Despite the impressive growth of trade, GMS economies are small in world markets, with a combined share in world trade of 1.5%, up from 1% at the beginning of the 1990s.

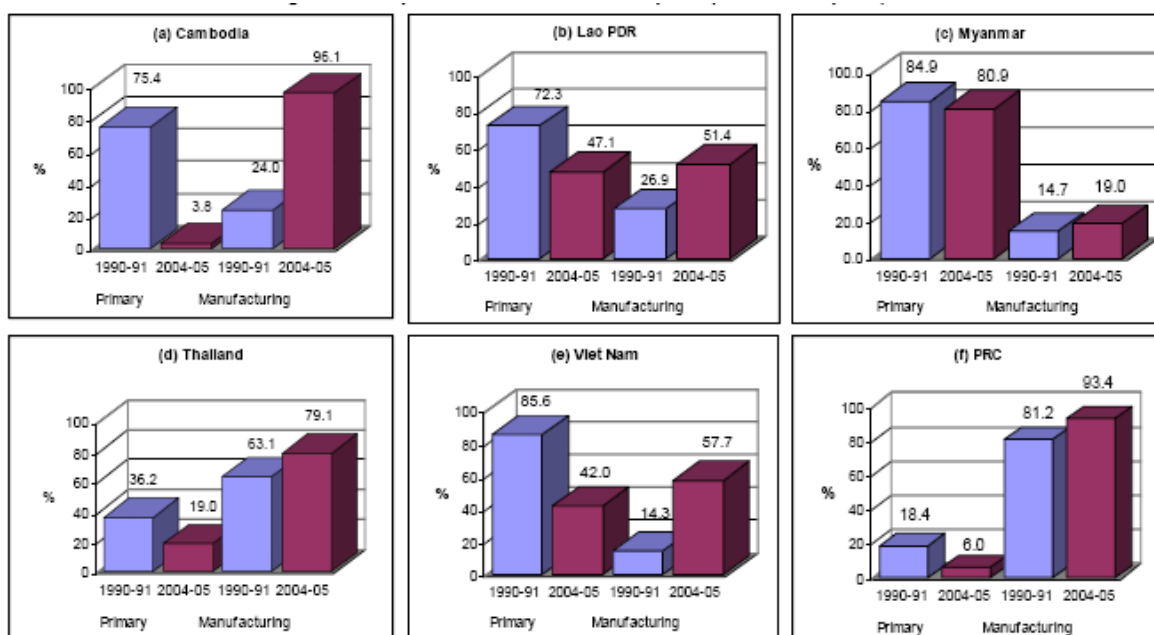
III. EVOLUTION OF EXPORT STRUCTURE

Comparable data across GMS economies for the commodity composition of their trade are not available (Box 2). The following discussion is based on partner country data compiled from the UN Comtrade database for the six GMS countries.

The increase in GMS countries' trade has been accompanied by a marked change in the commodity structure of exports (Figure 2). The structure has evolved according to each country's comparative advantage. GMS countries are generally rich in agricultural and natural resources and, with its low-cost labor, possess a competitive edge in labor-intensive manufactured goods. Liberalization of trade and investment, improvements in infrastructure albeit from a low base, and greater access to external markets have contributed to the shift in exports from primary commodities to labor-intensive manufactured goods. As noted in Section II, much of this shift is being driven by FDI.

Figure 2: Composition of Merchandise Exports (% of total exports)

Source: Compiled from partner country data in UN COMTRADE database. The sum



of shares for primary products, manufactured products, and products not classified (SITC 9) add up to 100. Products not classified (SITC 9) are not included in the charts.

This shift is evident in all the countries. It is particularly large in Cambodia, where clothing exports benefited from earlier access to developed country markets (Figure 3). Manufactured products from the Lao PDR and Viet Nam have also risen significantly, comprising more than half of total exports. Primary products remain important in these countries.

Clothing exports comprise about 80% of the Lao PDR's manufactured exports, mostly destined to the EU. The remainder consists mainly of resource-based manufactures, particularly mineral products, which have experienced a sharp rise recently and are likely not fully reflected in the data.

Viet Nam's manufactured exports are also dominated by light consumer goods, but they are more diversified (Figure 4). Apart from clothing and footwear, processed food, wood products, leather goods and, significantly, machinery and equipment have gained in importance. Most of the machinery exports consist of electrical and electronic products whose share rose from 0.2% of total exports in the early 1990s to 5.6% in recent years. This reflects the country's gradually increasing strength in labor-intensive assembly operations in vertically integrated high-tech industries and is similar to the earlier experience of Thailand and the PRC.

The import structure has remained relatively stable and is dominated in all countries by manufactured products, primarily machinery and equipment and resource-based manufactures. This is not surprising considering their need to import capital goods and the import intensity of their manufactured exports, such as the import of textile for clothing and of electronic products for assembly and re-export.

IV. DIRECTION OF TRADE

GMS countries' trade expanded rapidly both within the subregion and with the outside world over the last decade. Excluding the PRC, intra-GMS exports rose at an annual average rate of 19% during 1994–2006, while their exports to other countries increased at an annual average rate of 11%. The rise in exports to the PRC was even faster at an average

Box 2. Data Sources

The UN Comtrade database contains commodity trade data since 1990 by reporter for only PRC and Thailand, among the GMS countries. For this report, we have compiled data on commodity composition of trade from partner country records. We use trading partners' import records to compile data for a given GMS country's exports and export records of partner countries to compile a given GMS country's imports.

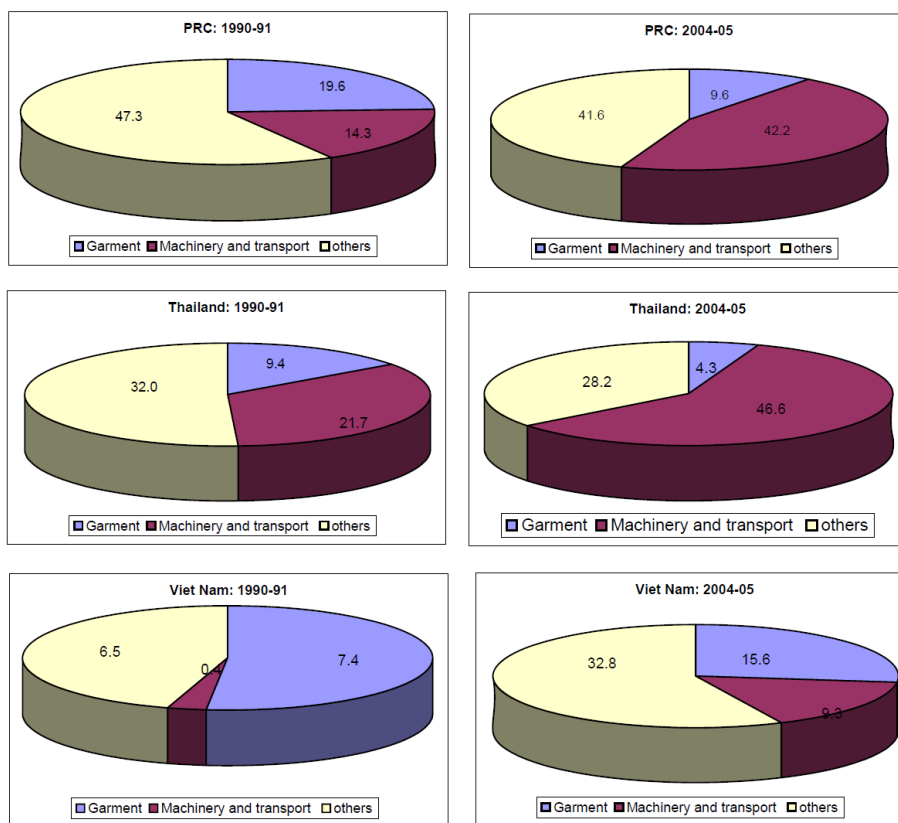
The value of trade flows of a country, based on partner country records, can differ from those based on own records because of differences in (i) valuation since exports are on free on board (FOB) basis and imports are on cost, insurance and freight (CIF) basis; (ii) the actual timing and reporting of trade transactions; and (iii) irregularities in reporting systems, such as unrecorded cross-border trade, underinvoicing/overinvoicing, smuggling, etc.

It is generally believed that the use of reporting country or partner country data does not make much of a difference to the analysis of trade composition. Some analysts prefer partner country data to reporting country data for trade analysis on grounds of consistency and accuracy (see e.g. Feenstra et al. 2005). First, developing countries tend to trade more with developed countries that generally have better data reporting systems. Second, in the presence of entrepot trade, export data from importers' records are less susceptible to double counting and erroneous identification of the source/destination country than are data based on reporting country records. Third, there are normally legal penalties for incorrectly specifying import information on customs declarations. Data compiled from importer records may, thus, be less susceptible to recording errors and reveal the origins and composition of trade more accurately than reporter countries' export data. Finally, in the GMS, where unrecorded cross-border trade is significant, importers' data on exports of trading partners would include some of this missing information on cross-border trade.

annual rate of 22%. Exports to non-GMS members of the ASEAN Free Trade Area (AFTA)—Indonesia, Malaysia, Philippines, and Singapore—and to “other East Asia” (Hong Kong, China; Republic of Korea; and Japan) each rose 9% annually on average, while those to the rest of the world (primarily the United States and EU) increased at the same rate as exports to the world. The pattern for imports was similar, with imports from all country/regional groups increasing at healthy rates. In contrast to the trend in exports, however, imports from non-GMS AFTA rose faster than those from the world, while those from the residual category “rest of the world” increased at a slower rate.

Figure 4: Composition of Manufactured Exports (% of total exports)

These trends hold for all individual countries (with the exception of Myanmar’s trade with the “rest of the world”) and are reflective of the broadly outward-oriented trade strategies of GMS countries. Specifically, the growth in imports from all regions suggest that AFTA and various other regional trade agreements have not diverted trade away from nonregional partners. GMS economies’ trade with ASEAN, as well as the United States and EU, has mostly been



Source: UN COMTRADE database – compiled from partner country data.

determined by MFN, rather than preferential tariff rates. This is similar to the experience of older members of AFTA. The rate of utilization of the Common Effective Preferential Tariff (CEPT) rates under AFTA is low as ASEAN countries have historically lowered their MFN rates along with their CEPT rates, and the difference between the two is not significant enough to compensate for the administrative complexity of complying with rules of origin requirements (Baldwin 2007, Feridhanusetyawan 2005).

Figure 5 shows the evolution of trade shares of GMS countries with different country/regional groupings between 1994–1996 and 2004–2006. Their share of trade with other GMS countries, especially the PRC, rose sharply, albeit from a low base. Their share of trade with non-GMS AFTA countries was stable, with the fall in the share of exports to those countries offset by the rise in their import share. Trade shares with other East Asian economies and the rest of the world declined modestly. In spite of the rise in intra-GMS trade shares, however, countries outside the ASEAN region are the GMS countries' largest trading partners, reflecting their size and higher incomes per capita.

Much of this trend in the geographic orientation of trade reflects the change in the trade share of Thailand, the largest trader among GMS countries (excluding the PRC). For the smaller countries, there are marked differences. The share of Cambodia's trade with other GMS countries (excluding the PRC) and with non-GMS AFTA countries fell sharply over the last decade with its specialization in garments, most of which are sold in the United States and, to a lesser extent, the EU.

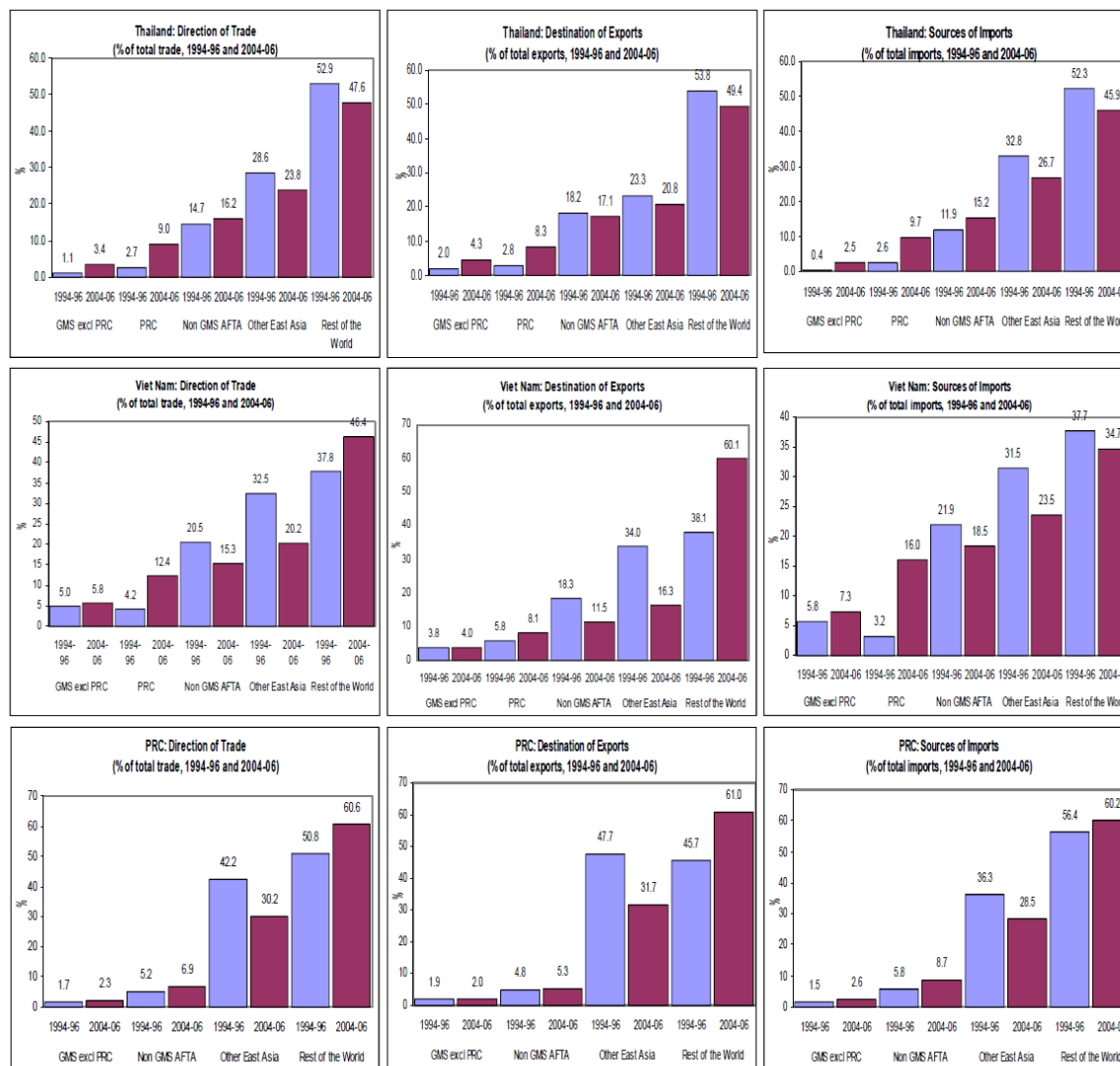
The Lao PDR is the most dependent on the GMS for its trade, partly reflecting its landlocked geography and relatively greater remoteness from other major markets. However, as the country becomes more linked with regional and global economies with improvements in cross-border infrastructure and greater market access, its export dependence on the subregion is declining.

Viet Nam's trade share with other GMS countries, excluding PRC, rose modestly over the last decade. The PRC is increasing in importance to Viet Nam as an export market and as a source of imports. As access to markets in EU and the United States increased, their share in Viet Nam's exports also rose. The share of trade with non-GMS AFTA and other East Asian economies declined over the last decade, but they remain important trading partners, especially as a source of imports.

Figure 5: Direction of Trade, Destination of Exports, and Sources of Imports



Figure 5: (cont'd): Direction of Trade, Destination of Exports, and Sources of Imports



Note: GMS excl PRC = Cambodia, Lao PDR, Myanmar, Thailand, Viet Nam; non-GMS AFTA = Indonesia, Malaysia, Philippines, Singapore; "other East Asia" = Hong Kong, China; Republic of Korea; Japan.

Source: IMF Direction of Trade Statistics.

V. OPPORTUNITIES TO ENHANCE TRADE

The preceding results suggest that the outward-oriented policies implemented over the last decade and a half by GMS countries, coupled with better access to world markets, have led to a substantial increase in trade with their neighbors and with the outside world. The opportunities for enhancing trade further are large. First, the GMS economies themselves have grown at one of the fastest rates over the last decade and a half and are located close to the rapidly-growing markets in the PRC and India, suggesting strong demand for their products. Second, with a relative abundance of agricultural resources, the GMS economies stand to benefit from the globalization of processed food markets. With the agriculture sector accounting for 50–70% of employment in CLV countries, growth in production and exports from this sector will be necessary to improve incomes and reduce poverty in these countries.

Third, the ongoing process of product fragmentation and the growing importance of East Asia in the manufacture and assembly of components also suggest that newcomers to export-led industrialization, such as the GMS economies, will have increased opportunities for export expansion. Fourth, market access has continued to improve in recent years both in ASEAN and in developed countries outside the region, for example, with the Lao PDR's normal trade relations (NTR) status in the United States since 2005 and Viet Nam's WTO membership in 2007. ASEAN's ongoing efforts to forge closer economic partnerships with major markets, including PRC, India, Japan, Republic of Korea, among others, in the region are also likely to promote CLV countries' access further. Finally, in spite of the rapid growth of exports in the past, the GMS economies' share of world imports for most commodities remains small, indicating substantial scope for increasing exports without adversely affecting their terms of trade.

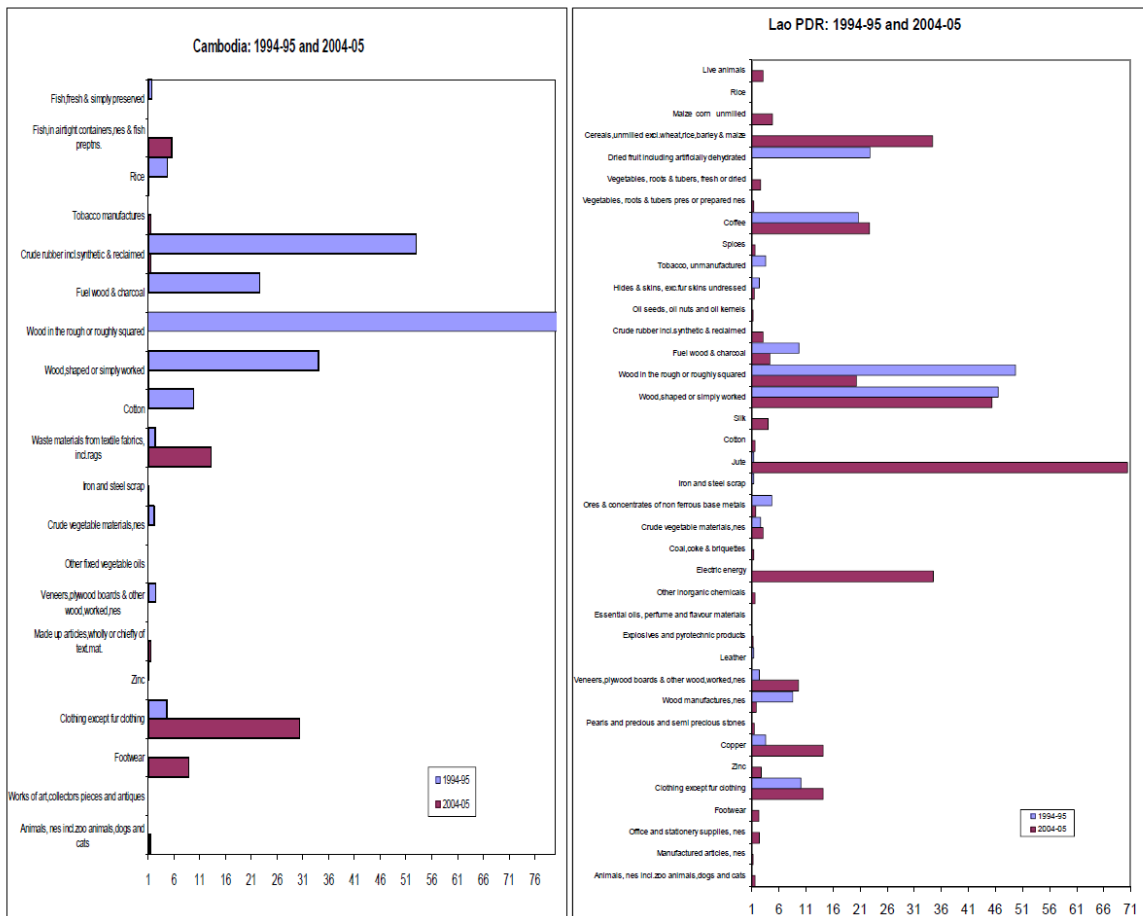
As noted earlier, CLV countries have a comparative advantage in agricultural and natural resources and in labor-intensive manufactured goods. The change in export structures over the years reflects the evolution of their comparative advantage from predominantly primary products toward labor-intensive manufactured goods. The “revealed” comparative advantage (RCA) indices confirm these patterns.¹

Cambodia's advantage in primary products has generally eroded over the years, largely reflecting its specialization in garment exports (Figure 6). The RCA indices for wood, cotton, fresh fish, wood products, crude rubber, and rice, for example, have fallen over the last decade, although it retains a (marginal) advantage in the last three commodities. The comparative advantage in clothing, footwear, processed fish, and some textile materials have increased notably over the period.

¹ The revealed comparative advantage (RCA) index is the ratio of the share of a product in a country's exports to the share of the product in world trade. It is an indicator of the relative importance of a particular country, as a source of exports of a given product, compared to the relative importance of that product in total world trade. If the value of the RCA index exceeds unity for the product, then the country is said to have a ‘revealed’ comparative advantage in that product. If the RCA index is below one, the country does not show a comparative advantage in the product.

The Lao PDR shows an increase in comparative advantage in a number of agricultural and natural-resource products, including cereals, vegetables, crude rubber, coffee, spices, silk, jute, copper, zinc, and electric energy. Its comparative advantage in wood and wood products, which has eroded in the past decade, remains significant. Among manufactured products, the comparative advantage in clothing remains dominant, while that in footwear has increased modestly.

Figure 6: Revealed Comparative Advantage Indices



Note: The revealed comparative advantage (RCA) index is the ratio of the share of a product in a country's exports to the share of the product in world trade. If the value of the RCA index exceeds unity for the product, then the country is said to have a 'revealed' comparative advantage in that product. If the RCA index is below one, the country does not show a comparative advantage in the product. The charts show products for which the RCA index exceeds unity. Source: Compiled from UN COMTRADE database country data.

Figure 6: (cont'd): Revealed Comparative Advantage Indices



Source: Compiled from UN COMTRADE database country data.

Viet Nam possesses an advantage in a large number of agro-based products, such as fresh and processed fish, rice, fresh fruit and nuts, coffee, tea, and spices, among others. Within manufacturing, apart from clothing and footwear, Viet Nam's advantage lies in leather products and wood products; and it has gained advantage over the last decade in others, including pottery, cutlery, furniture, and notably, some machinery and equipment. It retains a (smaller) advantage in crude and refined oil products than it did a decade ago.

The observed comparative advantage of CLV countries and its evolution over time depend on a number of factors in addition to differences in resource endowments. These include trade policy (tariff and nontariff barriers), technology, geography (a country's proximity to large markets and access to navigable waters), quality of institutions and infrastructure, the level of education and knowledge of its workers, among others (Deardoff 2005, Belloc 2006).

For instance, geography is an important determinant of the extent to which a country can become integrated into world markets (Venables 2006). A distant, landlocked country faces natural disadvantages in foreign trade both in terms of cost of transportation and the time involved in meeting customers' demand. Improvements in infrastructure would enhance trade flows and benefit sectors that use infrastructure services more intensively. A study of Latin American countries, for example, found that the main beneficiaries of a reduction in transport costs were agriculture, natural-resource-intensive, and labor-intensive sectors (de Ferranti et al., 2002, p.18).

Some of these determinants, such as climate and the availability of arable land, are relatively fixed while others, such as the level of education and skills of the workforce, the quality of infrastructure and institutions, and technology, evolve over time, either because of government policy or because of feedback effects as a country develops. As these determinants change over time, a country's comparative advantage changes and so does its pattern of trade. Further enhancement of trade by CLV countries and the evolution of their comparative

advantage will, thus, depend on policies on tariff and nontariff barriers, social and physical infrastructure, and development of institutions, coupled with policies to maintain macroeconomic stability.

VI. IMPEDIMENTS TO TRADE AND CHALLENGES

As CLV countries integrate more closely with external markets, competitive pressures on domestic industries will increase. The abolition of textile and garment quotas with the expiration of the WTO Agreement on Textiles and Clothing at end-2004 illustrates the potential rise in competitive pressures. CLV countries emerged largely unscathed as the quotas were removed partly because they have developed a comparative advantage in these products and partly because of safeguard measures invoked by the United States and EU in the second half of 2005 on imports of garments from the PRC (ADB 2006b, ADB 2006c). However, with the safeguard measures set to expire in 2008, competition is likely to intensify again.

The potential increase in competitive pressures both from within the subregion and from other developing countries underscores the need to further reduce impediments to trade, improve the general business environment, and raise overall economic competitiveness. These measures will be especially important for Cambodia and the Lao PDR to diversify their economic structures in order to mitigate vulnerabilities to swings in external demand. Unleashing the export potential of CLV countries will require further progress in rationalizing tariff and nontariff (e.g., quotas, licensing) barriers; in measures to facilitate trade and transport; and in efforts to relieve constraints on private sector development; and in developing the capacity to meet international food safety standards; while maintaining macroeconomic stability.

Despite the reduction in tariff rates over the last decade and a half, there is scope for further progress in rationalizing trade policy. In the Lao PDR, for example, even with the substantial improvement in trade policy over the years, licensing requirements for imports and exports, especially at the provincial level, remain cumbersome. Furthermore, in Cambodia and Viet Nam, as well as in the Lao PDR, although average tariff rates have fallen, they follow a cascading structure, with the tariff rate escalating with the degree of processing of a product.

Table 2 presents the simple (unweighted) averages of the MFN rates applied on imports from most countries and the CEPT rates applied on ASEAN imports. It also shows the average margin of preference (the difference between MFN and CEPT rates) given to imports from ASEAN and the rate of dispersion of the MFN rates around the average rate. The average MFN rates are relatively low for the Lao PDR and are on the high side for Cambodia and Viet Nam.

Tariffs and nontariff barriers raise the cost of imported inputs for companies. Since exporters from CLV countries are small in relation to world markets, they cannot raise their prices in international markets to absorb the higher cost of imported inputs. Producers for the domestic markets, on the other hand, are protected by the tariff on their products. Exporters are, thus, at a disadvantage relative to producers for the domestic markets when tariffs exist. As long as tariffs are not zero, some anti-export bias will continue to exist. However, when tariff rates escalate with the degree of processing, as the rate of dispersion suggests, the effective

rate of protection on final goods produced for the domestic market is higher than that implied by the nominal tariff rate. The dispersion is relatively high for Viet Nam, partly reflecting its larger and more diversified trade, but it is also suggestive of greater protection accorded to producers for the domestic market.

Table 2: Tariff Rates (2005)

	MFN	CEPT	MoP	Dispersion
Cambodia	14.3	9.7	4.6	70.7
Lao PDR	9.6	4.4	5.2	77.2
Viet Nam	16.9	2.5	14.4	114.6

Note:

MFN = Simple (unweighted) average of Most-favored Nation tariff rate applied on imports from most countries.

CEPT = Simple (unweighted) average of Common Effective Preferential Tariff rates applied on ASEAN imports.

MoP = Margin of preference, computed as the difference between average MFN and CEPT rates.

Dispersion is calculated as the coefficient of variation of the MFN rates.

Source: Compiled from tariff data in ASEAN Secretariat database, available www.asean-sec.org

In order to reduce this anti-export bias, CLV countries allow exporters duty-free access to intermediate imports. Import duties collected as a share of total merchandise imports in CLV countries are generally low ranging from 3.6% for Cambodia to 7.9% for Viet Nam, partly reflecting duty exemptions.¹ However, the procedures for determining duty exemption are onerous and allow for substantial administrative discretion. A move toward a (low) uniform tariff rate across products would minimize the anti-export bias and increase administrative efficiency.

Furthermore, since Viet Nam was scheduled to reduce tariffs to 0–5% on most products under the CEPT scheme earlier than Cambodia and Lao PDR, its CEPT rate is lower and comparable to that of Thailand. The average margin of preference in Viet Nam is, thus, higher than for the other two countries, suggesting scope for greater uniformity in intra- and extra-ASEAN tariff rates. A high margin of preference raises the risk of trade diversion, as well as trade deflection.²

¹ Import duties as a share of total merchandise imports were 3.6% in Cambodia in 2003–2005 and 7.9% in Viet Nam during 1998–2000; in comparison, they were 2.7% in Thailand during 2003–2005 (WTO Country Profiles, April 2007). In the Lao PDR, they were 5% in 2003–2004 (CPI et al. 2006, p. 28).

² If the difference between tariff rates applied on imports from non-ASEAN countries relative to those applied on ASEAN imports (margin of preference) is high, this will create an incentive for CLV import-

As tariff and quantitative restrictions on trade have been progressively reduced, other trade costs arising from regulatory burden, inadequate infrastructure, and generally inefficient customs procedures and logistics of moving goods across borders have become much more significant. The costs to trade of inadequate infrastructure and cumbersome regulatory environment are believed to be substantially higher than those from tariffs and nontariff barriers.¹

Poor transport and logistics networks not only raise the direct costs of freight and storage but also impose substantial costs from delays in transit time.² Lengthy and uncertain transit times will require a larger buffer-stock of inventory at destination to accommodate the uncertain time of delivery of goods. The cost of transit delays is particularly high for time-sensitive goods, such as perishable agricultural products and seasonal or fashion apparel. These are some of the products in which CLV countries have a comparative advantage. As countries specialize in particular stages of production in a regional or global supply chain, improved quality of transport infrastructure becomes even more important. The frequent need to import intermediate goods for processing for reexport will require a reliable transport and logistics network.

Table 3 presents selected indicators for education, transport, and communications for Cambodia, Lao PDR, and Viet Nam. The data reveal substantial progress in raising adult literacy rates. The primary school completion rate is also better in comparison to other low-income countries. Paved roads, as a share of total road network, is marginally higher in Cambodia and Lao PDR than in the average low-income country. Indicators for information and communications are generally lagging the average for low-income countries, except in Viet Nam. The data suggest that, although CLV countries made substan-

ers to source imports from ASEAN suppliers even if they are less efficient (more costly) compared to those outside of ASEAN. This diversion of trade can be costly to the importing countries because of the loss of tariff revenues from the lower rate applied on ASEAN imports and the higher cost of imports. A high margin of preference also raises the risk of trade deflection. Under AFTA, ASEAN members are allowed to individually determine tariff rates on non-ASEAN imports. This creates an incentive for non-ASEAN imports to enter ASEAN through its member with the lowest tariff, thus depriving the member which eventually consumes the imports of tariff revenues. The rules of origin that are implemented to minimize trade deflection are cumbersome to administer especially for developing countries, such as the CLV where administrative capacity is limited. As ASEAN has negotiated or is considering free trade agreements (FTAs) with other countries, such as PRC, Japan, India, Republic of Korea and the EU members. The increasing number of FTAs, with different tariff schedules, has the potential to complicate customs administration further.

¹ For industrialized countries, Anderson and van Wincoop (2004, pp. 692–693) estimated trade costs equivalent to a tax of 170%, comprising 55% in local distribution costs and an additional 74% in international trade costs. Of the international trade costs, transport costs accounted for 21% and border-related barriers accounted for 44%, of which tariff and nontariff (policy) barriers accounted for 8%.

² Hummels (2001) estimated that, for ocean shipments of manufactured goods to the United States, each day saved in transit time is worth 0.8% of the value of the goods. Similarly, Djankov et al. (2006) estimate that, on average, each additional day that a product is delayed prior to being shipped reduces trade by at least 1%.

tial progress in the past decade and a half in rehabilitating social and physical infrastructure, there is a substantial need for increasing the amount and efficiency of investments in these areas especially in Cambodia and Lao PDR. While Viet Nam's indicators appear significantly better than those of an average low-income country, improved delivery of social and physical infrastructure services will be necessary as it moves toward middle-income status over the medium term.

Table 3: Selected Education and Infrastructure Indicators

Country	Adult Literacy rate		Primary completion rate	Paved Roads (%)	Telephone mainlines per 1000 people	Mobile subscribers per 1000 people	Internet Users per 1000 people
	1990	2006	2005		2005	2005	2005
Cambodia	62.0	73.6	92.3	16.2	2.7 ^c	75.5	3.0 ^d
Lao PDR	56.5	68.7	75.9	14.4	12.7	107.7	4.2
Viet Nam	--	90.3	93.5	25.1	191.0	115.4	128.9
Low income	48.3	60.9	73.9 ^a	13.3	37.0	46.8	44.2

^a Figure is for 2004.

^b For Cambodia and Viet Nam, the data are for 1998; for Lao PDR 2003; and 1999 for low income countries.

^c Figure is for 2003.

^d Figure is for 2004.

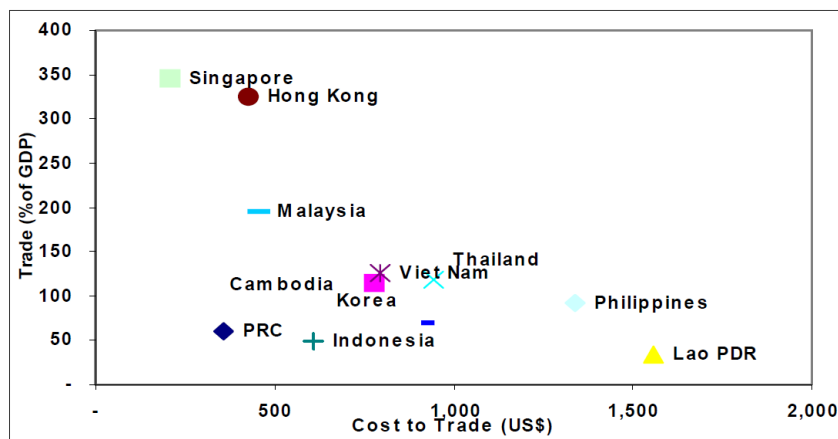
Low income countries are those with 2006 per capita gross national income of US\$ 905 or less. Source: World Development Indicators Online, downloaded 27 August 2007.

Figure 7 shows the association between the cost of trading across borders and trade openness (the sum of exports and imports as a percentage of GDP) for a group of East Asian economies.¹ Not surprisingly, trade tends to be higher if costs to trade are lower. **Figure 8** shows a similar relationship between the time required to trade across borders and trade openness. The cost and time required to trade in the Lao PDR is especially high and is partly attributable to its landlocked geography, relatively greater remoteness from major markets, and rugged terrain.

Most of the time required to trade in all GMS countries is spent on preparation of documents (**Figure 9**). However, the time required in CLV countries for document prepara-

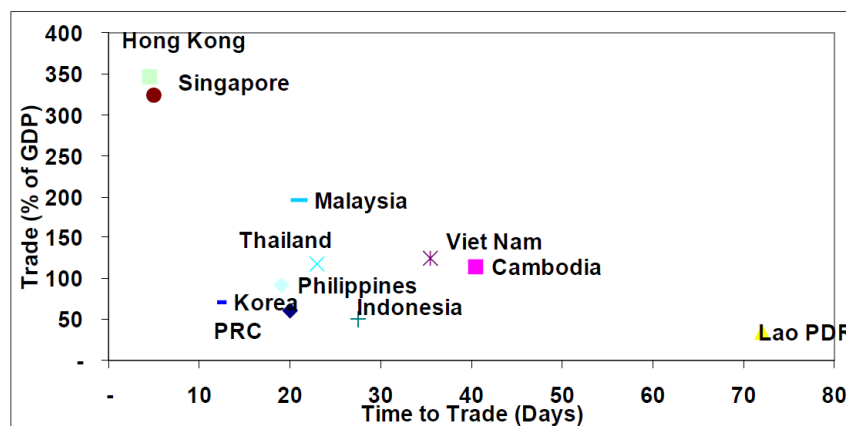
¹ The data refer to the process of moving a 20-foot full container load of dry cargo. For exporting goods, procedures range from packing the goods at the factory to their departure from the port of exit. For importing goods, they range from the vessel's arrival at the port of entry to the cargo's delivery at the factory warehouse. Relevant procedures for clearance across borders are also included. See www.doingbusiness.org for further details on methodology.

Figure 7: Cost to Trade Across Borders and Trade Openness



Sources: Doingbusiness database, available <http://doingbusiness.org>; and ADB.

Figure 8: Time to Trade Across Borders and Trade Openness

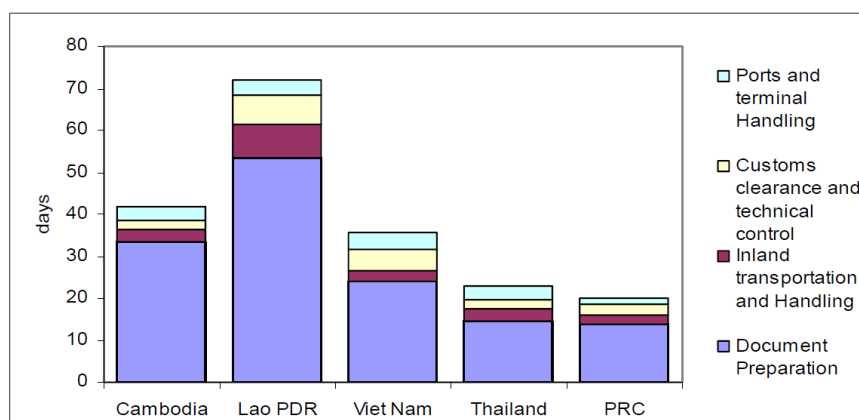


Sources: Doingbusiness database, available <http://doingbusiness.org>; and ADB.

tion is significantly higher than that in the PRC and Thailand. The time required in the Lao PDR is particularly high, partly reflecting elaborate licensing and approval procedures for imports and exports. There are, for example, 16 documents required for imports in the Lao PDR compared with 12 in Cambodia and 9 in Viet Nam. For exports, 12 documents are required, twice the number in Cambodia and Viet Nam. The time required to clear customs takes relatively longer in the Lao PDR and Viet Nam, at an average of 7 and 5 days, respectively, for exports and imports, compared with about 2 days in the PRC and Thailand.

Apart from impediments to trade, other constraints on the domestic investment environment can impose heavy costs on businesses, damping their ability to compete in international markets. Investment climate surveys of businesses on their perceptions of the main constraints indicate that poor governance, regulatory burden and uncertainty, inadequate access to land and to finance, and deficient infrastructure all impose substantial costs (see e.g., ADB 2006, World Bank 2004).

Figure 9: Time to Trade Across Borders and its Components



Source: Doingbusiness database, available <http://doingbusiness.org>.

The top constraints vary by country. In Cambodia, businesses perceive broad governance issues, including corruption, crime, legal, and regulatory uncertainty as the main constraints. In the Lao PDR, businesses perceive deficient infrastructure, regulatory uncertainty, and access to finance as the main obstacles. Firms in Viet Nam identify inadequate access to land, insufficient access to finance, and deficient infrastructure as the main obstacles. These constraints are perceived to be higher by firms in Cambodia, Lao PDR, and Viet Nam, respectively, than by similar businesses in either East Asia or other developing countries.

The CLV countries' capacity to meet the requirements for product quality in major export markets will also be an important determinant of their export growth. With the potential for a significant increase in processed food exports, the WTO Sanitary and Phytosanitary Measures Agreement and the related dispute settlement mechanisms are of particular significance.¹ Harmonization of national standards with international norms, where appropriate, would facilitate CLV countries' exports. As in other developing countries, the main constraint in this respect is the low level of technical and scientific know-how and the costs involved in propagating standard SPS practices among producers and setting up a national monitoring system.

¹ Under AFTA and the WTO, member countries have to ensure compliance with the WTO agreements on Technical Barriers to Trade and on Sanitary and Phytosanitary Measures. The agreements allow countries to set their own standards, but (i) they must be based on science; (ii) they should be applied only to the extent necessary to protect health and the environment or to meet other consumer interests; and (iii) they should not arbitrarily or unjustifiably discriminate between countries where identical or similar conditions prevail.

VII. CONCLUSIONS AND POLICY IMPLICATIONS

GMS economies' trade has expanded rapidly over the last decade and a half as they liberalized their economies toward a market-based system, gained greater access to regional and developed country markets, and improved their infrastructure and institutions to promote trade. Expanding trade further is a key element of the development strategies of CLV countries. With their proximity to rapidly-growing markets in the region, potential for linkages to regional and global supply chains, further increase in their access to regional and developed country markets, and their still-small share in world markets, CLV countries have significant opportunities for export growth. However, increased integration will also raise competitive pressures for domestic industries, underscoring the importance of relieving constraints on trade and investment to improve overall economic efficiency. CLV countries have substantially reformed their trade policy. However, there is additional scope for rationalization. Achieving greater uniformity in tariff rates across products and countries, especially in Viet Nam, would be desirable to reduce the bias against exports, and the risk of trade diversion and deflection as CLV countries participate, through their membership in ASEAN, in an increasing number of free trade agreements.

One concern in moving toward (low) uniform tariff rates across products and countries is the possible adverse impact of low tariffs on government revenue, especially in Cambodia and Lao PDR. Both countries rely significantly on customs receipts as a source of government revenues. However, a number of factors are likely to mitigate the impact of lower tariff rates on government revenues. First, the loss of revenues from lower tariffs will be offset to some extent by the likely increase in the volume of imports. Second, lower and more uniform tariff rates should reduce the incentives for smuggling and result in higher receipts to the government. Third, improvement in customs administration, partly aided by more uniform tariffs, has the potential to increase customs receipts significantly. Developing countries that implemented customs reforms have, in many cases, increased revenues by a factor of 2, and sometimes more, within a short period of time (Engman 2005).

Furthermore, the high share of customs receipts in government revenues of Cambodia and Lao PDR, to a large extent, reflects a narrow domestic tax base and insufficient rigor in tax administration. Government revenues in the two countries amount to a modest 11% of GDP, compared with more than 20% in Viet Nam, underscoring the need to improve tax administration. Over the medium to longer term, revenues from exports of minerals and electricity in the Lao PDR and prospective oil receipts in Cambodia are also likely to reduce their dependence on customs revenues.

As tariff and quantitative restrictions on trade have been progressively reduced, the costs to trade of cumbersome regulations, inadequate infrastructure, and general inefficiencies in customs and logistics of moving goods across borders have become much more significant. These impediments dampen trade not only by raising the direct monetary costs but also from the delays in transit times especially for time-sensitive products. There is significant scope to reduce these impediments, especially relatively longer times required to trade, in the Lao PDR in particular, but also in Cambodia and Viet Nam, through streamlining of documents and procedures, customs reforms, and better infrastructure and logistics.

Apart from these obstacles, some broader constraints on the domestic investment environment impose heavy costs on businesses, potentially restraining their ability to compete in international markets. Investment climate surveys conducted by ADB and the World Bank suggest that in Cambodia, businesses perceive broad governance issues, including corruption, crime, legal and regulatory uncertainty as the main constraints. In the Lao PDR, deficient infrastructure, regulatory uncertainty, and access to finance are listed as the main obstacles. Firms in Viet Nam identify inadequate access to land, insufficient access to finance, and deficient infrastructure as the main obstacles. These constraints are perceived to be higher by firms in Cambodia, Lao PDR, and Viet Nam, respectively, than by similar businesses in either East Asia or other developing countries.

Relieving these constraints would reduce the costs of doing business, increase predictability of the policy environment, and help increase private sector investment. In Cambodia, this will require quicker implementation of policies to simplify regulations, improve enforcement, and reduce administrative discretion. In the Lao PDR, provision of infrastructure, cited by businesses as the main constraint, will require policies to encourage participation of private investors, especially foreign ones. Raising public investment in infrastructure will also require further progress on fiscal reforms in order to raise sufficient revenues to meet financing requirements.

In the Lao PDR and Viet Nam, the constraints also underscore the importance of ongoing reforms to restructure state-owned banks, which are dominant in the provision of finance, with the aim of ultimately privatizing them. In Viet Nam, access to land will depend on developing markets for land-use rights, which can then be used as collateral by companies. Much of the commercial property is owned by state-owned enterprises (SOEs). The ongoing equitization of SOEs, restructuring and equitizing state-owned commercial banks, nurturing healthy capital markets, and developing a sound regulatory environment for private sector participation in infrastructure are key reform priorities.

Meeting product quality standards to take advantage of the potential for agricultural and other exports will also require concerted efforts to develop necessary regulation and domestic capacity. CLV countries have gradually begun to develop capacity with the assistance of development partners. Regional cooperation could also aid in this process. Thailand, for example, has a proven track record in meeting SPS standards for processed food exports and in resolving SPS-related trade dispute. It, thus, has the potential to assist CLV countries in building their institutional capabilities to meet international food-safety standards.

The CLV countries are aware of the challenges to sustain and improve upon the successful record in enhancing trade and growth, as reflected in their medium-term development plans. Improving the overall climate for trade and investment is a process and will require not just funding but also technical assistance to explore international good practice in regulatory reform and adapt it to local circumstances, build capacity of government agencies, and help countries comply with commitments under AFTA, WTO, and other agreements.

Multilateral and bilateral organizations have been supporting the governments' efforts to better the environment for trade and investment. Under the GMS Economic Cooperation Program, for example, assistance from multilateral and bilateral agencies has led to greater connectivity among the GMS countries. The focus of cooperation has expanded to include more efficient customs and logistics. The GMS Cross-border Transport Agreement (CBTA), for example, aims to harmonize border-crossing procedures, ease restrictions on vehicles crossing the borders, and on transit traffic, among other measures. The agreement among GMS countries in March 2007 on the remaining annexes and protocols of the CBTA raises the prospects of freer movement of goods (and people) across the subregion. The Strategic Framework for Action on Trade Facilitation and Investment (SFA-TFI) aims to improve trade logistics, harmonize customs procedures, and strengthen the capacity of GMS economies to meet SPS standards, among other initiatives. Capacity development of key agencies involved in trade is a key element of SFA-TFI and CBTA. Similarly, the endorsement of the Core Agricultural Support Program (CASP) in April 2007 by GMS countries should contribute to enhanced trade within the subregion in agricultural products, a key potential source of export earnings for many countries in the subregion.

Tables A1.1 and A1.2 in the Appendix provide a preliminary and indicative pipeline of lending and technical assistance projects proposed to be supported by ADB, in cooperation with other development partners, under the GMS Economic Cooperation Program over the next 3 years. Many of these projects directly support trade-related infrastructure and capacity development in the GMS. The requirements for such assistance are large. The pipeline of projects comprises a portion of the priority projects identified by nine sector working groups of the GMS program. It is also complementary to the national programs of each GMS country, many of which are supported by other development partners, as well as by ADB.

Table A1. 1: Indicative Assistance Pipeline for Lending/Grant Products, 2008–2010

Sector	Project/Program Name	Countries Involved	Year of Project Preparatory Assistance	Cost (\$ million)				
				Total	ADB		Gov't	Cofinancing
					OCR	ADF ^a		
2008 Loans								
Energy								
1.	GMS Nabong-Udon Thani Power Transmission and Interconnection ^b	LAO	2007	84.0	74.0		74.0	10.0
2.	GMS Nam Ngum 3 Hydropower Project	LAO	2006	52.0	47.0		47.0	5.0
	Subtotal			136.0	121.0	-	121.0	15.0
Industry and Trade								
3.	GMS Sustainable Tourism Development Project	LAO	2005	15.0		10.0	10.0	2.0
4.	GMS Sustainable Tourism Development Project	VIE	2005	13.0		10.0	10.0	3.0
	Subtotal			28.0	-	20.0	20.0	5.0
Transport and Communications								
5.	Central Yunnan Roads Development (formerly Yunnan Roads Development IV [Wuding-Kunming])	PRC	2006	576.0	200.0		200.0	72.0
	Subtotal			576.0	200.0	-	200.0	304.0
	Total 2008 Firm			740.0	321.0	20.0	341.0	307.0

Sector Project/Program Name	Countries Involved	Year of Project Preparatory Assistance	Total	Cost (\$ million)				
				ADB			Gov't	Cofinancing
				OCR	ADF ^a	Total		
2009 Loans								
Firm								
Agriculture and Natural Resources								
1. GMS Flood and Drought Risk Management and Mitigation	CAM	2007	25.0		20.0	20.0	5.0	
2. GMS Flood and Drought Risk Management and Mitigation ^b	LAO	2007	20.0					20.0
3. GMS Flood and Drought Risk Management and Mitigation	VIE	2007	80.0		30.0	30.0	20.0	30.0
4. GMS Biofuel Development Project	CAM	2008	20.0		20.0	20.0		
5. GMS Biofuel Development Project ^b	LAO	2008	10.0		10.0	10.0		
6. GMS Biofuel Development Project ^b	VIE	2008	20.0		20.0	20.0		
Subtotal			175.0	-	100.0	100.0	25.0	50.0
Energy								
7. GMS Northern Power Transmission	LAO	2006	35.0		20.0	20.0	5.0	10.0
Subtotal			35.0	-	20.0	20.0	5.0	10.0
Health, Nutrition, and Social Protection								
8. GMS Capacity Building for HIV/AIDS Prevention	LAO	2008	10.5		5.0	5.0	0.5	5.0
9. GMS Capacity Building for HIV/AIDS Prevention	VIE	2008	18.0		15.0	15.0	3.0	
Subtotal			28.5	-	20.0	20.0	3.5	5.0
Transport and Communications								
10. Second GMS Northern Transport Network Improvement	LAO	2008	40.0		20.0	20.0	2.0	18.0
11. Second GMS Northern Transport Network Improvement	VIE	2008	95.0		75.0	75.0	20.0	
12. Nanning-Kunming Railway Capacity Expansion	PRC	2007	300.0	300.0		300.0		
13. GMS Cambodia Road Improvement II ^b	CAM	2008	20.0		20.0	20.0		
14. Western Yunnan Roads Development II (formerly [Ruili-Longlin] Expressway)	PRC	2006	250.0	250.0		250.0		
Subtotal			705.0	550.0	115.0	665.0	22.0	18.0
Water Supply and Sanitation								
15. Mekong Water Supply and Sanitation Project ^b	CAM	2008	22.0		14.0	14.0		8.0
16. Mekong Water Supply and Sanitation Project ^b	LAO	2008	11.0		7.0	7.0		4.0
17. Mekong Water Supply and Sanitation Project ^b	VIE	2008	23.5		14.0	14.0	1.5	8.0
Subtotal			56.5	-	35.0	35.0	1.5	20.0
Total 2009 Firm			1,000.0	550.0	290.0	840.0	57.0	103.0

Sector Project/Program Name	Countries Involved	Year of Project Preparatory Assistance	Cost (\$ million)					
			Total	ADB		Gov't	Cofinancing	
				OCR	ADF ^a			Total
2010 Loans								
Agriculture and Natural Resources								
1. GMS Biodiversity Conservation Corridor ^b	CAM	2009	40.0		30.0	30.0	3.0	7.0
2. GMS Biodiversity Conservation Corridor	LAO	2009	42.0		20.0	20.0	2.0	20.0
3. GMS Biodiversity Conservation Corridor	VIE	2009	70.0		30.0	30.0	10.0	30.0
Subtotal			152.0	-	80.0	80.0	15.0	57.0
Health, Nutrition, and Social Protection								
4. GMS Communicable Disease Control 2 ^b	CAM	2009	10.5		9.0	9.0	1.5	
5. GMS Communicable Disease Control 2 ^b	LAO	2009	12.8		10.0	10.0	0.8	2.0
6. GMS Communicable Disease Control 2 ^b	VIE	2009	18.0		15.0	15.0	3.0	
Subtotal			41.3	-	34.0	34.0	5.3	2.0
Transport and Communications								
7. GMS: Ha Long-Mong Cai Highway	VIE	2009	250.0	100.0	100.0	200.0	50.0	-
Subtotal			250.0	100.0	100.0	200.0	50.0	-
Total 2010 Firm			443.3	100.0	214.0	314.0	70.3	59.0
Total 2008-2010			2,183.3	971.0	524.0	1,495.0	219.3	469.0

ADB = Asian Development Bank; ADF = Asian Development Fund; GMS = Greater Mekong Subregion; ISD = inclusive social development OCR = ordinary capital resources.

^a Subject to funds availability.

^b To be confirmed with governments concerned and/or subject to availability of additional subregional ADF resources.

Source: ADB

Table A1. 2: Indicative Assistance Pipeline for Nonlending Products and Services, 2008–2010

Sector Project/Program Name	Countries Involved	Assistance Type	Indicative Source of Funding				Total (\$'000)
			ADB		Others ^a		
			Source	Amount (\$'000)	Source	Amount (\$'000)	
2008							
Agriculture and Natural Resources							
1. Program to Support the Implementation of the Core Agricultural Sector Program (includes Supporting Capacity Strengthening and Regional Cooperation in Agriculture Science and Technology in the GMS [Phase 2])	GMS	RETA			PRC & RCIF	2,500.00	2,500.00
2. GMS Biofuel Development Project ^b	CAM/LAO/VIE	PPTA	TASF	1,000.00			1,000.00
Subtotal				1,000.00		2,500.00	3,500.00
Energy							
3. Facilitating Sustainable, Environment-Friendly Regional Power Trading in the Greater Mekong Subregion Phase 2 (Study on the PRC-Lao PDR-Cambodia Power Interconnection and Transmission Improvement)	CAM/LAO/PRC	RETA			PRC, RCIF, Sweden ^c	2,000.00	2,000.00
Subtotal						2,000.00	2,000.00
Health, Nutrition, and Social Protection							
4. GMS Capacity Building for HIV/AIDS Prevention	LAO/VIE	PPTA	TASF	500.00			500.00
Subtotal				500.00		-	500.00
Multisector							
5. Enhancing Transport and Trade Facilitation in the GMS	GMS	RETA			PRC, RCIF & Others	4,000.00	4,000.00
6. Implementing the GMS HRD Strategic Framework and Action Plan	GMS	RETA			RCIF	700.00	700.00
Subtotal						4,700.00	4,700.00
Transport and Communications							
7. Second GMS Northern Transport Network Improvement	LAO/VIE	PPTA	TASF				1,000.00

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Sector Project/Program Name	Countries Involved	Assistance Type	Indicative Source of Funding				Total (\$'000)
			ADB		Others ^a		
			Source	Amount (\$'000)	Source	Amount (\$'000)	
8. GMS Cambodia Road Improvement II	CAM	PPTA	TASF				600.00
Subtotal							1,600.00
Water Supply and Sanitation							
9. Mekong Water Supply and Sanitation Project ^b	CAM/LAO/VIE	PPTA	TASF	450.00	UN-HABITAT	500.00	950.00
Subtotal				450.00		500.00	950.00
Total 2008				3,550.00		9,700.00	13,250.00
2009							
Agriculture and Natural Resources							
1. GMS Biodiversity Conservation Corridor Program ^b	CAM/LAO/VIE	PPTA			RCIF	1,000.00	1,000.00
Subtotal						1,000.00	1,000.00
Energy							
2. Viet Nam-Guangxi, PRC Power Interconnection ^b	VIE	PPTA	TASF	1,000.00			1,000.00
Subtotal				1,000.00			1,000.00
Education							
3. GMS Phnom Penh Plan for Development Management	GMS	RETA	TASF	500.00	PRC	500.00	1,000.00
Subtotal				500.00		500.00	1,000.00
Health, Nutrition, and Social Protection							
4. GMS Communicable Disease Control Project 2	CAM/LAO/VIE	PPTA			RCIF	500.00	500.00
Subtotal						500.00	500.00
Multisector							
5. Trade Facilitation and Logistics Development in the GMS ^b	CAM/LAO/VIE	PPTA			RCIF	800.00	800.00
Subtotal						800.00	800.00
Transport and Communications							
6. GMS Ha Long-Mong Cai Highway	VIE	PPTA	TASF	1,000.00			1,000.00
Subtotal				1,000.00			1,000.00
Total 2009				2,500.00		2,800.00	5,300.00

Sector Project/Program Name	Countries Involved	Assistance Type	Indicative Source of Funding				Total (\$'000)
			ADB		Others ^a		
			Source	Amount (\$'000)	Source	Amount (\$'000)	
2010							
Agriculture and Natural Resources							
1. Support for the Implementation of the Core Agricultural Sector Program	GMS	RETA		-	RCIF	1,000.00	1,000.00
Subtotal						1,000.00	1,000.00
Energy							
2. Developing the Regional Transmission and Regulatory Authority	GMS	RETA		-	France	1,000.00	1,000.00
Subtotal						1,000.00	1,000.00
Multisector							
3. Strengthening the Coordination of the GMS Program	GMS	RETA			PRC & RCIF	3,000.00	3,000.00
4. Implementing the GMS HRD Strategic Framework and Action Plan, Phase 2	GMS	RETA			RCIF	700.00	700.00
5. GMS Border Towns Development ^b	LAO	PPTA	TASF	500.00	PRC	500.00	1,000.00
Subtotal				500.00		4,200.00	4,700.00
Transport and Communications							
6. GMS Southern Coastal Corridor Phase 2	VIE	PPTA	TASF	1,000.00			1,000.00
Subtotal				1,000.00			1,000.00
Total 2010				1,500.00		6,200.00	7,700.00
Total 2008-2010				7,550.00		18,700.00	26,250.00

ADB = Asian Development Bank; CAM = Cambodia; GMS = Greater Mekong Subregion; HABITAT = United Nations Centre for Human Settlements; HIV/AIDS = human immunodeficiency virus/ acquired immunodeficiency syndrome; HRD = human resources development; JSF = Japan Special Fund; LAO = Lao People's Democratic Republic; PPTA = project preparatory technical assistance; PRC = People's Republic of China; RCIF = regional cooperation and integration fund; RETA = regional technical assistance; TASF = technical assistance special fund; THA = Thailand; VIE = Viet Nam.

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Background Paper for South Asia

Appendix 2

Prepared by the South Asia Department of the Asian Development Bank
September 2007

ABBREVIATIONS

ADB	–	Asian Development Bank
EU	–	European Union
GDP	–	Gross Domestic Product
IT	–	Information Technology
KEI	–	Knowledge Economy Index
LCL	–	Less than Truckload
LDC	–	Less Developed Country
LTL	–	Less than Container Load
RETA	–	Regional Technical Assistance
SAARC	–	South Asian Association for Regional Cooperation
SASEC	–	South Asia Subregional Economic Cooperation
SME	–	Small and Medium Enterprise
TA	–	Technical Assistance

I. SOUTH ASIAN STRUCTURE OF ECONOMY AND TRADE IN WORLD PERSPECTIVE

1. South Asia has experienced high growth averaging close to 6 percent per year since the 1990s. This is evident from the table 1 (for India, which is by far the largest economy in South Asia). This growth was triggered by first-generation policy reforms in 1991, as is evident in the table from the increased growth rate since (the table is from Bosworth and Collins, 2007). With this came the acceleration of labor productivity in India, as the table shows after 1993. India's performance also compares favorable with that of East Asia prior to the financial crisis in 1997. South Asian strong growth is overshadowed by the even more remarkable performance of China.
2. As is also evident from figure 1, growth has been especially in the case of India uneven in terms of sectors and geography. Growth rates in South Asia generally have been lagging in agriculture, that is in the rural areas, behind those in manufacturing and industry, and the services sector. In the case of India, this has been reflected in a steady increase in the ratio of urban to rural real consumption levels. As growth in South Asia has also been driven by export growth and trade liberalization in the manufacturing and services sectors, it will be important in the future to consider how the agriculture and rural sectors can be included in export driven growth. This uneven trade driven growth is an issue to be noted later in this issues paper.

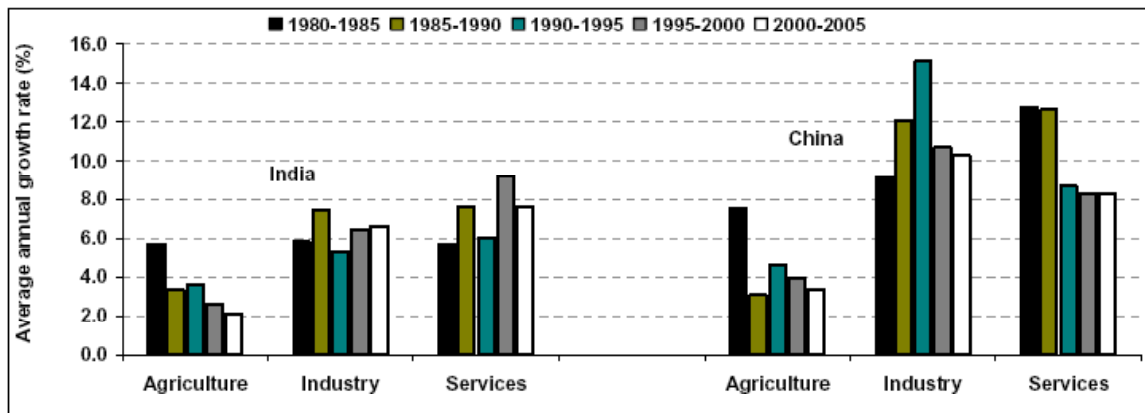
Table 1. Sources of Growth: China, India, and East Asia 1978-2004

Annual percentage rate of change

Period	Output	Employment	Output per Worker	Contribution of:				
				Physical Capital	Land	Education	Factor Productivity	
Total Economy								
1978-04	China	9.3	2.0	7.3	3.2	0.0	0.2	3.8
	India	5.4	2.0	3.3	1.3	0.0	0.4	1.6
1978-93	China	8.9	2.5	6.4	2.5	-0.1	0.2	3.6
	India	4.5	2.1	2.4	1.0	-0.1	0.3	1.1
1993-04	China	9.7	1.2	8.5	4.2	0.0	0.2	4.0
	India	6.5	1.9	4.6	1.8	0.0	0.4	2.3
East Asia Excluding China								
1960-80		7.0	3.0	4.0	2.2		0.5	1.2
1980-03		6.1	2.4	3.7	2.2		0.5	0.9
1980-93		7.3	2.7	4.6	2.6		0.6	1.4
1993-03		4.5	2.0	2.5	1.8		0.5	0.3

Source: Authors' estimates as described in text; Bosworth and Collins (2003). The employment series is a census comparable concept for both China and India.

Figure 1: Sector GDP growth rates in China and India, 1980-2005



Source: China Statistical Yearbook (various years); Central Survey Organization, Government of India

- Modern Asian economies have substantially liberalized foreign trade, as is evident from their rising export share as percent of GDP. The increasing intraregional trade in South Asia, the improved physical connectivity, and the rapid growth of emerging economies such as India, the spread of vertically integrated production and outsourcing networks (supply chains and value chains), have brought some Asian economies ever closer together. The benefits have been palpable. South Asia, especially India, has reduced the share of the poor living in the economies. Exports have increased the size of markets and thus income opportunities. Remittances and foreign direct investment have added savings which can be invested in domestic projects. Technology and technology transfer have made the economies more productive. Yet, the potential for capturing more of these benefits is also evident. The export shares as percent of GDP of South Asian economies still fall below world average, and are comparatively low when measured by its South East Asian neighbors. It also appears that after 2001, the export shares' curves have been flat, in the case of Nepal the curve declines. This again highlights the issue of uneven distribution of export growth.

Figure 2: Exports as GDP

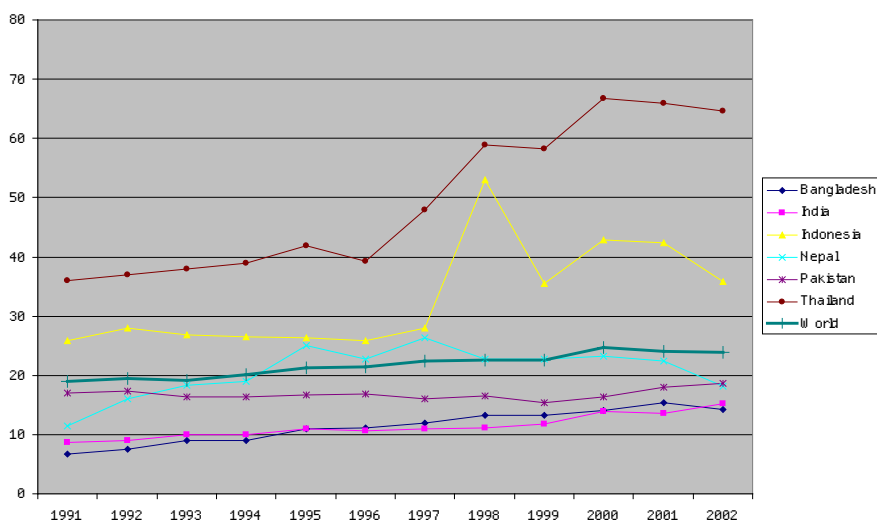
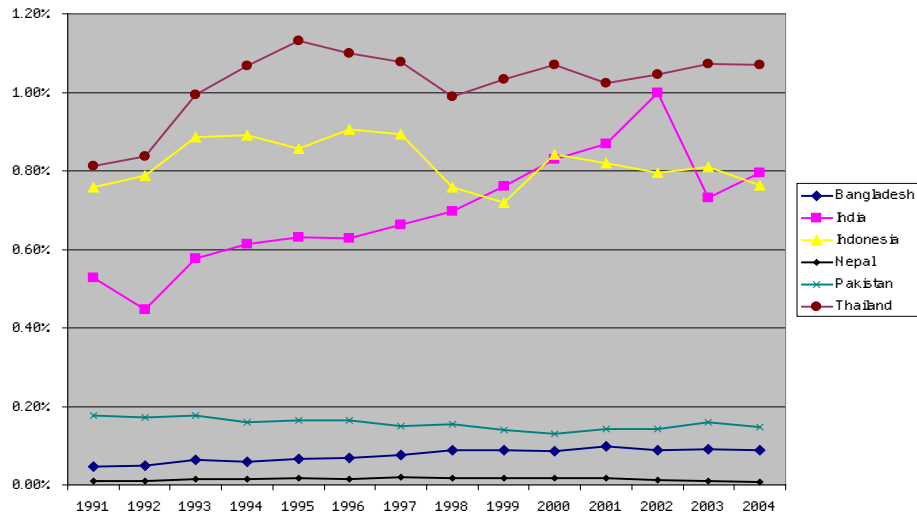


Figure 3: Shares in World Exports

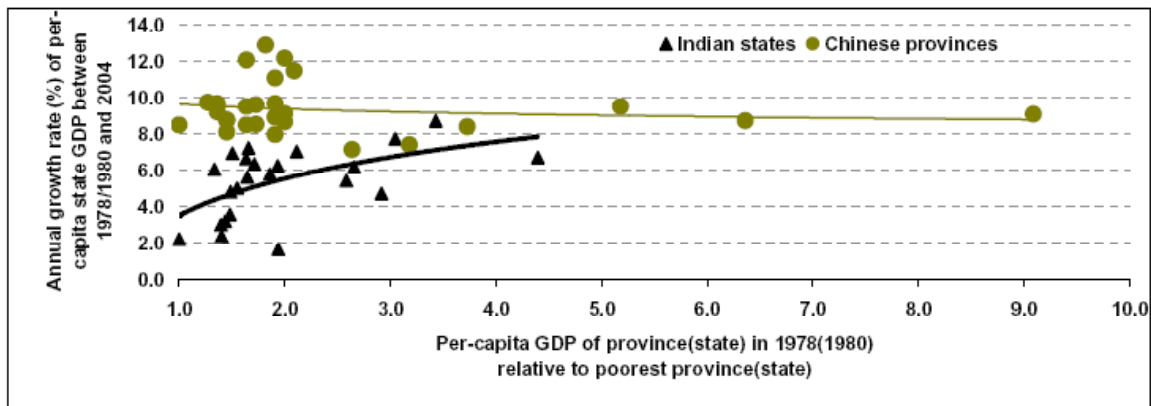


Source: Brunner and Cali (2005).

II. HIGHLIGHTS OF KEY ISSUES

- The issue of uneven sector and geographic distribution of trade driven growth has already been highlighted. It is important to note that export and growth success perpetuates itself over decades (Figure 4 taken from Chaudhuri and Ravallion, 2006). In comparison to fast growing China, the figure 4 shows that growth rates at the state level in India are far more determined by past growth performance (hence the upward slope of the black curve) than the provinces in China. In India, states that were initially (in 1980) poorer continued to grow much slower than initially richer states, resulting in income divergence in both absolute and relative terms. The fast growing states are also the ones benefiting most from trade growth, and they are largely the ones that are located at the western and southern coastal areas of India.

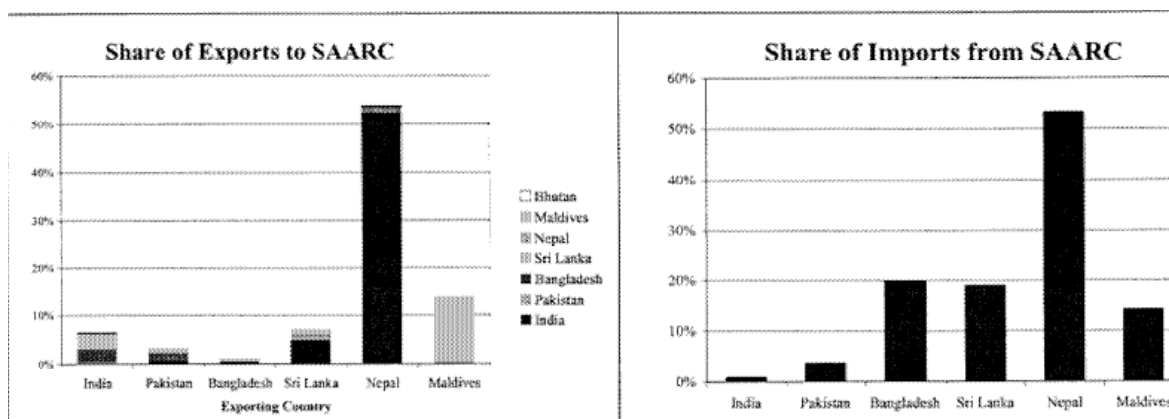
Figure 4: Growth Rates at the Sub-national Level in China and India



Source: China Statistical Yearbook (various years); Central Survey Organization, Government of India

- Regional inequality is a threat to the region’s continuing growth and stability. Several lagging regions in South Asia are border economies. They are landlocked or geographically isolated. Examples are northern Bangladesh, Bhutan, northeast India, northwest Pakistan, and parts of Nepal. These sub-regions have poor connectivity, difficult access to information and markets within the country, with the neighbors, and the rest of the world. Moreover, trade integration within the region remains limited. This is primarily due to government constraints on trade especially non-tariff barriers. Also, South Asian countries have maintained higher levels of protection among themselves than with the rest of the world. Nepal is the only country with a high trade share in SAARC. (Figure 5 a and b)

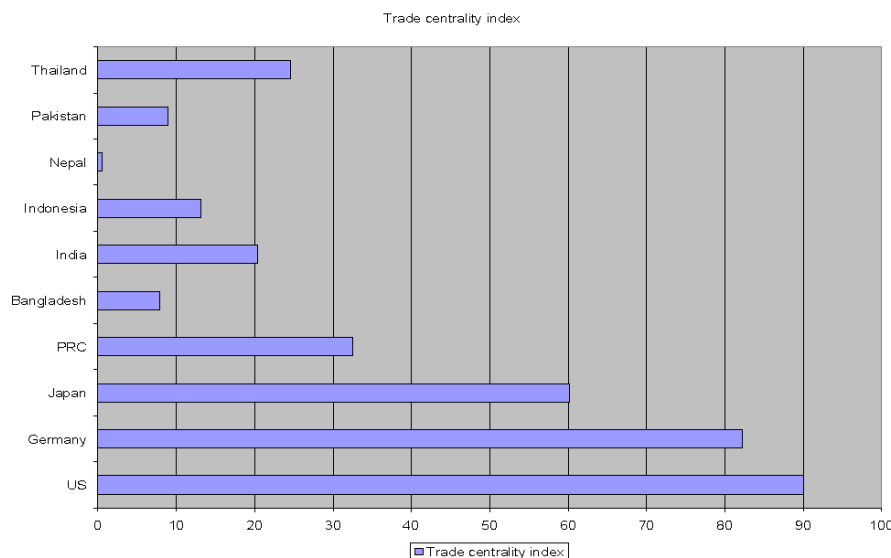
Figure 5 a and b: Export and Import among SAARC Economies as Percent of Total Trade by Value



- Regional trade integration and cooperation could play a useful role in ensuring that no country or region in South Asia is left behind in availing of trade opportunities. Trade liberalization and lowering of non-tariff barriers when managed well has generally induced positive structural changes in Asian economies. In South Asia the impact of trade liberalization has been more pronounced and positive in countries and regions which were better prepared to avail of economic opportunities and more capable to absorb the cost of adjustments, with appropriate supply side policies and investment support, and which have had better ex ante access and connectivity to regional and world markets.
- Figure 6 highlights an economy’s capacity to reap the benefits from trade and growth of world markets. The Kali and Reyes (2006) calculation of a “Trade centrality index” for most countries in the world reflects an economy’s number of trading partners, and the influence of countries on product supply and value chains which connect the inputs to products and services (supply) via vertically integrated trade networks across many countries to the customer who demands the finally assembled product and service. A high relative value of centrality (on a scale from 0 to 100) reflects a central position of influence within key global supply and value chains. For South Asia, this measure provides important insights into global trade positioning: South Asia is still relatively marginal to global supply and value chain (outsourcing and integration) in comparison to

the key players US, Japan, Europe, and increasingly China. Of all major economies in South Asia, India is the most centrally connected trade economy, Nepal the least.

Figure 6: Trade Centrality Index



- The South Asian LDCs are vulnerable to vagaries and costs of getting a few (quality, standards, and time-sensitive) products via supply chains into a few competitive markets. In table 2 shares of export are displayed based on weight, rather than value, for the principal and central markets and commodities. Textiles and apparel are dominant among the three major commodity groups, except for India. The EU is the central market for Bangladesh, while there are more balanced shipments to the EU, and North America for India, Sri Lanka, and Pakistan. North America is very central to Nepal only. Although there are fluctuation in these export shares from year to year, these shares haven been stable for the last five years.

Table 2: South Asia Export by Volume, in percent (2003)

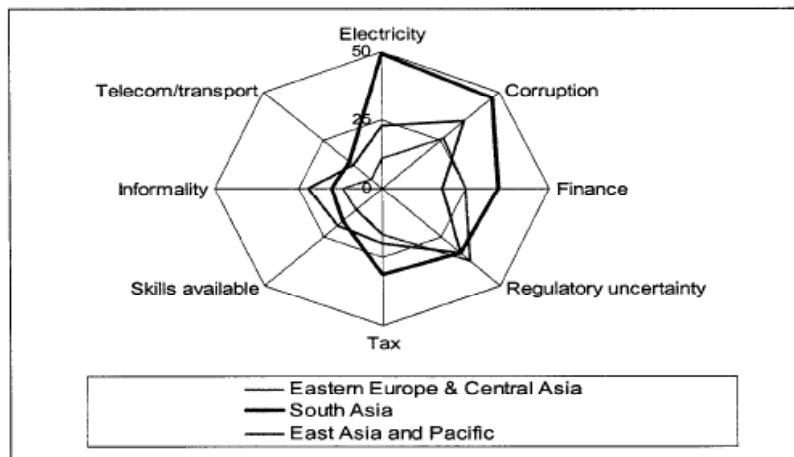
	India	Bangladesh	Nepal	Pakistan	Sri Lanka
ASEAN	24	2	2	13	1
European Union	42	65	14	45	49
NAFTA	34	32	84	42	50
Fish	18	7	1	8	4
Vegetables	46	1	0	20	10
Textiles	36	92	99	72	85
Total (000 tons)	1,071.9	597.0	13.2	364.8	174.1

Source: U.N. COMTRADE data from importing countries, adjusted by author.

Note: ASEAN-10 (Association of Southeast Asian Nations) countries; European Union-25 countries; NAFTA, North American Free Trade Agreement.

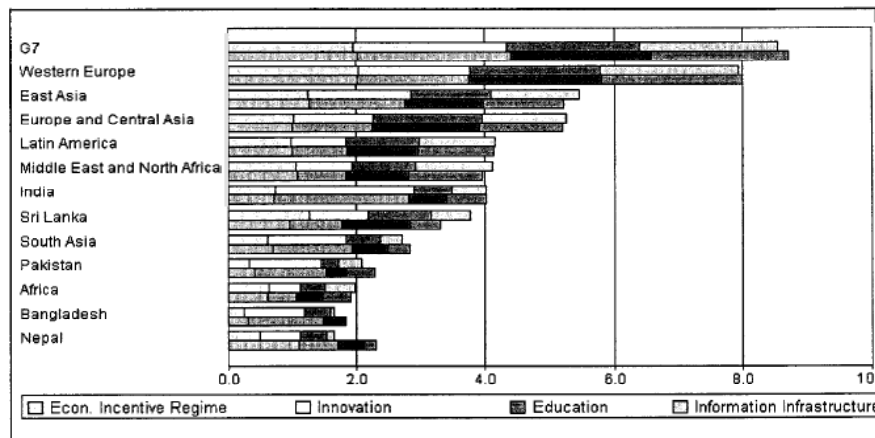
9. The following graphs, taken from the 2007 World Bank report on South Asia—Growth and Regional Integration, highlight the ailments that marginalize and render uncompetitive in a globally connected economy the South Asian suppliers and SMEs, especially in the LDCs, and more remote regions of South Asia. Trade infrastructure is the key concern for most exporters. Unofficial payments and the uncertainty of the standards that will be imposed, reduces their incentive to invest and to expand. Regulatory burden, particularly tax, customs, and labor regulation is high in South Asia by comparison. South Asia also underperforms on knowledge economy (Knowledge Economy Index – KEI) in comparison to other developing regions. India does best on the KEI. Notable is the fall in the economic incentive regime (business environment) in Nepal. Bangladesh slips most in the innovation index.

Figure 7: Share of South Asia Firms Reporting the Issues as a “Major” or “Severe” Constraint on the Operation of their Business



Source: Investment Climate Surveys. (See Chapter 3)

Figure 8: Comparison of Knowledge Economy Index (KEI) Component Parts for World Regions with South Asia



Source: www.worldbank.org/kam.

Note: The top bar represents the most recent aggregate KEI score for a selected region or country, split into the four KEI pillars. Each color band represents the relative weight of a particular pillar to the overall country's or region's knowledge readiness, measured by the KEI. The first line for each country is its position in the most recent year for which data are available (generally 2002–3). The second line is for 1995. This figure has been computed using the un-weighted variables for the innovation index.

- The issues of uneven sector and geographic distribution of trade benefits, and of South Asia's low regional trade integration, and relatively low connectivity and centrality in global trade networks have already been highlighted. These issues arise in part from South Asia's relatively high cross-border trade costs from costly and time consuming customs arrangements, procedures and documents for import and export, and from inadequate and congested border infrastructure (land-border infrastructure, and major ports).

Figure 9: Cost of Cross-Border Trade for World Regions Compared with South Asia

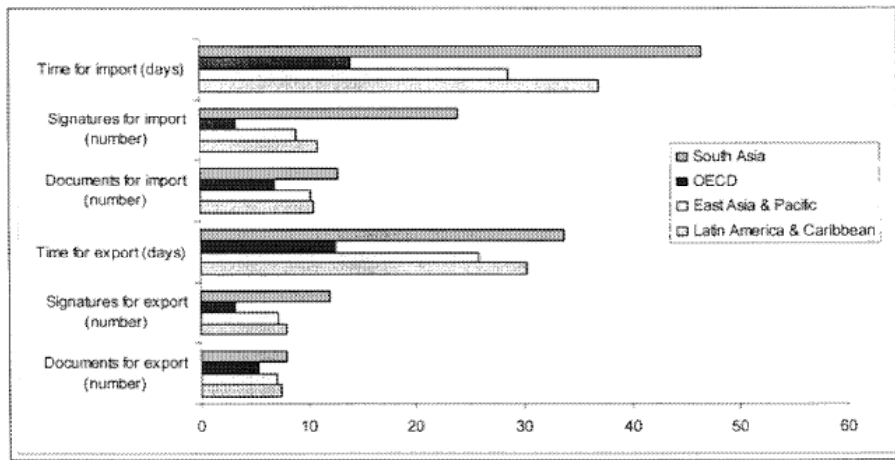
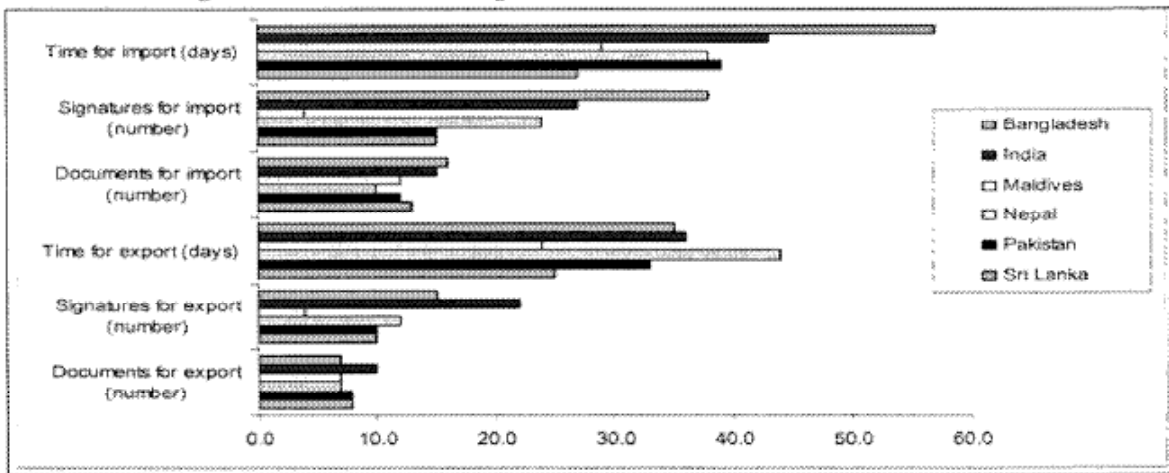


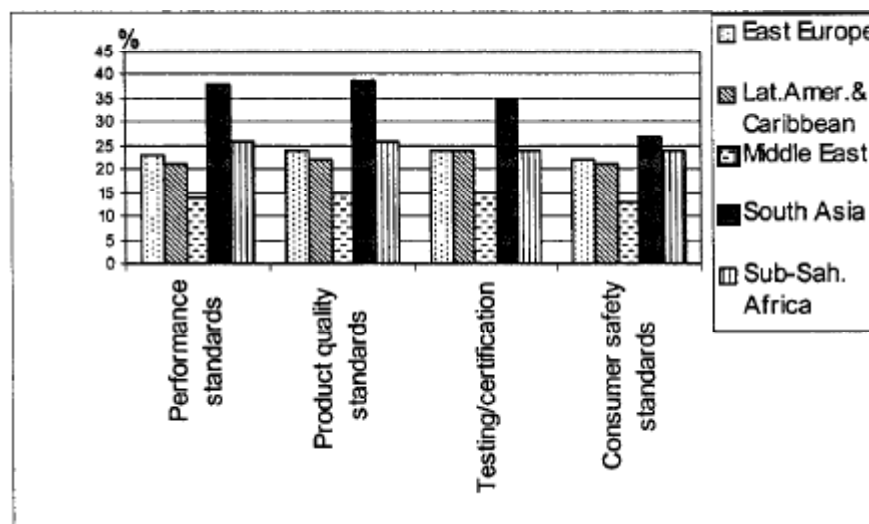
Figure 10: Cost of Trade for and among South Asian Countries



- Significantly adding to trade cost, LDCs do not have in place the know-how, institutional capacity, and infrastructure that combine into a product standards and conformity assessment system which invites international recognition. Especially in agro-based industries and trade, South Asian exporter SMEs fail to conform to sanitary and phytosani-

tary measures imposed by central export markets. As is shown in the graph, South Asian firms report standards, technical regulations and conformity assessment as very important to export success, and at a higher percentage than countries in other regions.

Figure 11: Percent of Firms Ranking Standards and Technical Regulations Important to Export Expansion



Source: Authors' calculations based on the World Bank Technical Barriers to Trade database.

12. South Asia now faces the challenge of second-generation reforms, liberalization measures, and capacity and logistics investments, to address key downside risks to growth and prosperity from the high cost of doing business, the weak institutions and SME capacities, the weak knowledge economy, and the weak infrastructure and connectivity. Trade related activities and investments for improving South Asia's trade networks and logistics, value chains, can be considered essential for making Aid for Trade for South Asia, and especially the LDCs and remote regions a success story.

Table 3: Issues overview

Issues	Effect	Underlying Constraints
Uneven sector and geography distribution of trade benefits	Urban areas experience higher real living standards than rural areas; some regions left behind (for instance northern Bangladesh, Bhutan, northeast India, north-west Pakistan, parts of Nepal);	Limited entrepreneurial pool and supply capacity; Low connectivity;
Limited integration with world markets and comparatively low South Asia trade integration	Some South Asian countries increase export share as percent of GDP and others are experiencing stagnating or falling shares;	Regulatory burden and negative business environment; non-tariff barriers and high cross-border trade costs;

Divergent capacity among countries and regions to avail of growth opportunities emerging from trade	Relative marginalization some countries or regions in global supply and value chains;	Insufficient trade-related infrastructure; difficult access to knowledge networks which are part of value chains;
South Asia LDC vulnerable to few low value added export products and markets	Uncertain income and growth perspectives;	Constrained SME access to finance for trade capacity and technology upgrading;

III. TRADE NETWORKS AND LOGISTICS, VALUE CHAINS: MAKE AID FOR TRADE WORK FOR LDCS AND REMOTE REGIONS

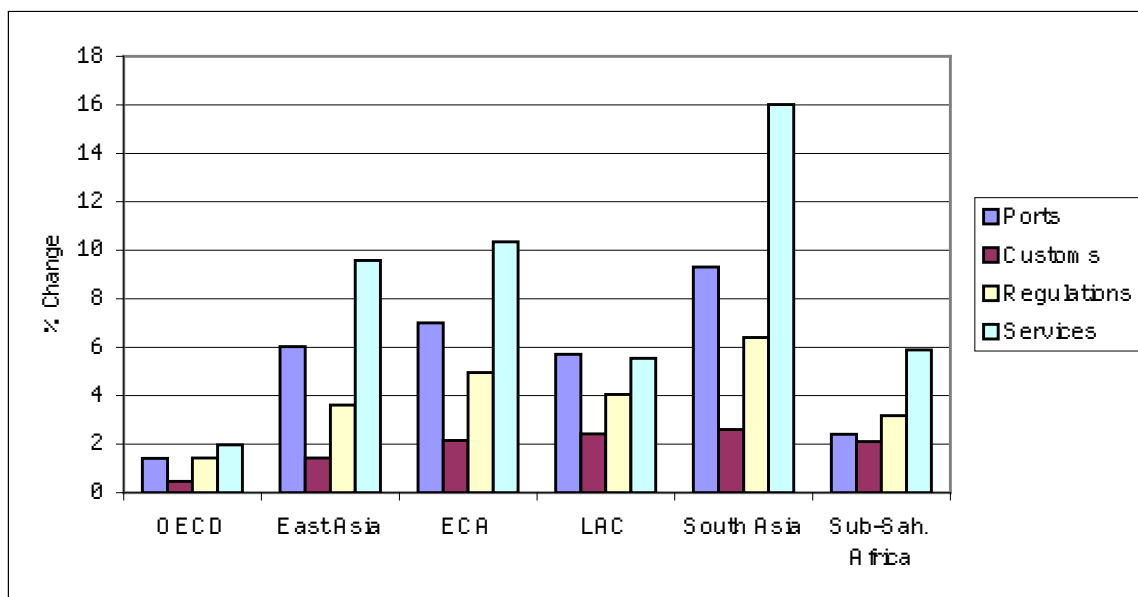
13. It is clear from the trade issues South Asia faces, that the region's competitive advantage in both regional and international trade rests on how effectively it can improve and invest in its logistics infrastructure, supply and value chains that link suppliers via the vertically integrated trade networks to customer demand. Competitive advantage from traditional proximity to raw materials or cheap labor has increasingly been replaced in the last decades by proximity to markets. The business capacity to produce time and quality sensitive consumer goods, and services has to be raised. Here Aid for Trade can be put to work with greatest benefit to the region.
14. One general strategy is to diversify trade in terms of sectors and markets. This is especially important for Bangladesh and Nepal, but also for Pakistan and Sri Lanka. It requires for instance the introduction of supply and value chains and complementary improvements in logistics and infrastructure. A second, possibly parallel strategy is to move into higher value added market segments within established sectors with increasing labor costs, as is the case for India. Another strategy for smaller and land-locked economies is to move into niche markets, possibly with higher value added, and to make use of subcontracting in proximity to larger markets, such as India. Fourth, pushing processing activities down the supply chain so as to allow greater differentiation in the characteristics of the product closer to the customer, and offering greater flexibility in serving small orders. All of this requires the necessary investment in capacity building, and investment in complete supply and value chains together with the necessary logistics and infrastructure investment.
15. Each of these strategies requires development of new and better supply chains. For new products, there are new sources for inputs, different processing sequences and different handling requirements. For new markets, there are differences in product standards and order cycle requirements. In some cases, the introduction of a new supply chain is itself the new product, for example, the introduction of ready-to-eat meals or on-the-rack garments. In others, the supply chain generates additional trade, for example, the trade in intermediate goods as a result of redistribution of the production process along a supply chain.

16. Among the factors that determine the structure of the inbound supply chains are the sourcing of inputs and the distribution of production activities. These have become quite complex with the emphasis on just-in-time production and multiple sourcing of imported inputs. The structure of outbound supply chains is determined by the organization of distribution by the wholesale/retail sector. These chains have become more complex despite efforts to reduce the number of transactions. This complexity result from the introduction of national networks with regional distribution centers to serve larger markets and the use of these centers to customize shipments for sub-markets. Effective retailing depends on these supply chains to coordinate sales activity and to insure availability of stock with minimal inventory.
17. Over the last decade and half, manufacturers, traders and retailers have focused on improving logistics as a mechanism for achieving competitiveness advantage. They recognized that most of the gains from improving production techniques and increasing labor productivity had already been achieved and were relatively easy to duplicate so that any competitive advantage was not sustainable. At the same time, there was a transition in retailing from production/technology push to market pull, which required producers and suppliers to increase flexibility and focus on the speed and reliability of delivery. Finally, there was increasing attention given to product quality, for which a significant component was determined by the inbound and outbound logistics.
18. The challenge for most LDCs is their limited resource base, which prevents them from achieving a significant scale of production, and relatively small per capita consumption, which prevents formation of an organized retail sector. Even where LDCs do not have these limits, their manufacturing, retailing and logistics sectors are dominated by SMEs which limits the opportunities for introduction of information processing systems, integrated supply chain management, and specialized third-party logistics service providers. For international trade they continue to rely on CIF shipments for imported inputs and FOB shipments for exported products with third-party logistics service providers being divided between local companies responsible for internal logistics and the international companies responsible for external logistics. In order to achieve economies of scale, the SMEs must utilize the volume discounts for transport services available to the larger international suppliers and buyers as well as the consolidation services for LTL and LCL shipments (less-than-truck-loads and less-than-container-loads) provided by the larger international forwarders, and the marketing networks of international traders, which extend beyond the limited trading opportunities offered by a country's Diaspora. The challenge is to replicate these economies of scale through international partnerships, subcontracting arrangements, and increased use of Internet-based B2B opportunities.
19. ADB has prepared, or will prepare a small set and critical set of operations in South Asia which implement these strategies, depending on the circumstances and the need or the country or remote region. A roadmap of these 'Aid for Trade' related interventions, past, present, and future is given in a separate table. Given high potential benefit and need of such interventions, there is room to apply more Aid for Trade in the region.

IV. BENEFITS AND SCOPE OF AID FOR TRADE IN SOUTH ASIA

20. Wilson, Mann and Otsuki (2004) estimated in absolute dollar and in relative terms the gains from trade facilitation/investment and capacity building by region and country, for instance South Asia, and Bangladesh, India, Pakistan and Sri Lanka, Trade facilitation indicators of the study, incorporate 'border' elements, such as increased port efficiency and better customs administration, and 'inside the border elements', such as country business and regulatory environment, and the infrastructure to enable e-business usage (so-called services). This definition relates to key issues highlighted earlier in this issues paper. Projected economic gains from interventions are large, as figure 12 shows in percent change of trade flow gains per year from collective trade facilitation intervention across the region. South Asia has the most to gain in comparison to all world regions, especially from trade-related infrastructure investment and combined with improvement of trade enhancing services. India and Bangladesh are projected to benefit the most.

Figure 12: Percent Change of Trade Flow Gains per Year from Collective Trade Facilitation Intervention across the Region



21. Estimates of gains from trade related investment in preparation of ADB operations have also come up with high benefits from combined, logistics infrastructure investment and investment in SME trade capacity, supply and value chain infrastructure development. For instance in preparation of ADB operations, the northeastern part of India's economy has been modeled on a map (Global Development Solutions, 2006, with New England Complex Systems Institute). All major economic activities expected to be affected by trade related transport/logistics and trade supply chain capacity building to firms in the region have been quantified and located. Economic interaction of actors (firms, labor) has been mapped across space, along transport and trade corridors and networks (also linked to the rest of the world). Similarly, in an extended model, financial and information interactions among economic players can be mapped. Economic development

interventions can then be evaluated for their economic and geographic impact. This can be done visually in a software program, where development practitioners insert their development intervention, and give details about the dimension of the intervention. In the case of the northeastern part of India, the following two charts simulate the significantly different economic impact, when as in figure 13, two economic interventions are timed and coordinated, one in logistics/transport infrastructure and the other one in reducing the business cost of trade between economic nodes and along transport corridors (value chain development, or competitiveness increase of SMEs), and when only logistics/transport infrastructure investment is under taken in isolation (figure 14). For each of the simulations, the maps in the top panels represent the spatial distribution of labor and employment. Purple represents available agricultural jobs, blue available high quality jobs. Dark green represents labor in agricultural jobs and light green labor in high quality jobs. Red represents unemployed labor. Time progresses from the left to the right and the panels below the maps are taken from immediately before the intervention, and then at intervals after the intervention to show the effect of the intervention.

22. The differences in terms of impact between the two projected approaches and scenarios are stark. A combined logistics/infrastructure and value chain improvement intervention for SMEs can double export and production, double qualified labor wage levels, and significantly reduce unemployment in the remote region. On the map, over time the employment benefits become more dispersed geographically (the sea of light green dots expands). In the second scenario (figure 14), there are hardly any export production gains (there is actually a visible “emigration of resources” effect from intervention), less income and employment gains, and those employment gains remain concentrated on the map.

Figure 13: Scenario - Trade Cost Reduction with Competitiveness and Supply Capacity Increase

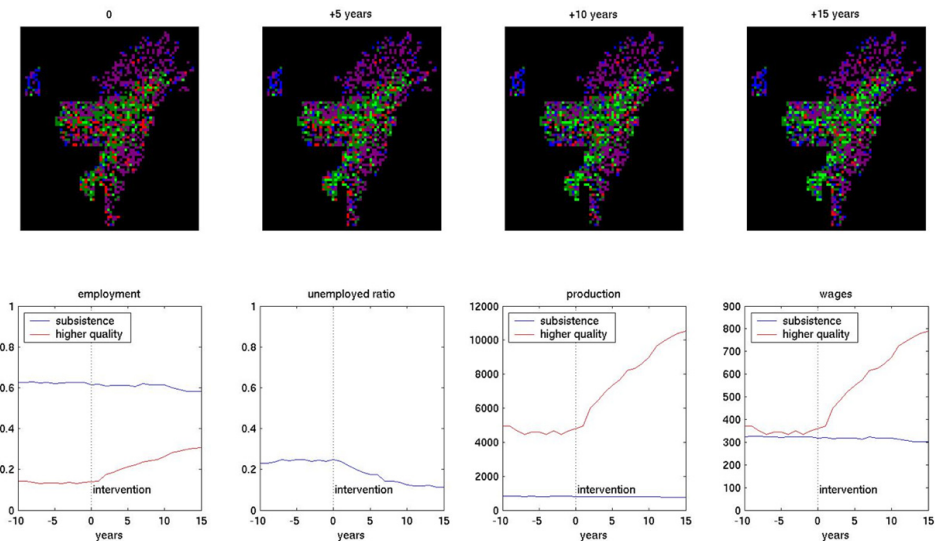
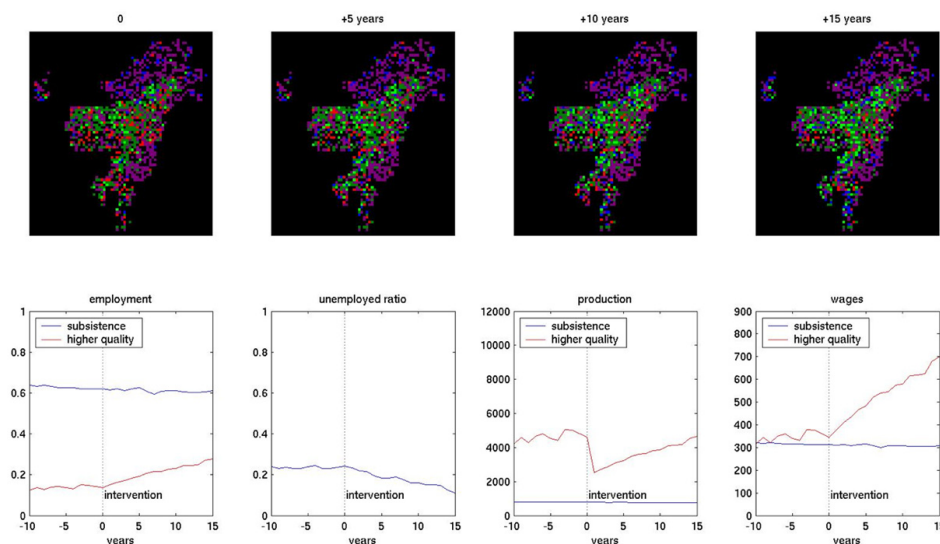


Figure 14: Scenario - Trade Cost Reduction Without Increasing Supply Capacity
 (No Competitiveness Increase)



23. In light of circumstances, the highlighted issues facing South Asia in terms of trade development, of the possible strategies for employing Aid for Trade to trade networks and logistics, and of value chains, especially in LDCs and remote areas of South Asia, and the potentially large economic development benefits as a result of trade interventions, the following tables 4 and 5 summarize suggested priority initiatives and their associated benefits and risks.

24. A key aspect of trade opening is tariff reforms and customs reform and harmonization. ADB has invested in tariff reforms and customs infrastructure along the India Nepal border. ADB is to undertake customs harmonization, and harmonization of product standards among the four countries of the South Asia Subregional Economic Cooperation (SASEC). Trade development particularly in the cross border or global sense has not been the explicit central objective of ADB in its South Asia level operations. However recent efforts at mainstreaming trade development, and emphasis on mobilizing Aid for Trade, will bring into sharper focus the macro spillover benefits for trade from the combination of a diverse set of operations, particularly through enhanced industrial, agriculture efficiency, and trade infrastructure development in India. Several trade related investments in these sectors are planned (see tables) Many private sector infrastructure and manufacturing projects financed by ADB have also had important implications for improving supply capacity for trade. By combining infrastructure, trade facilitation and reform, sector capacity building along supply and value chains in trade and SME hubs, crucial benefits emanating from economic corridors are realized.

25. ADB by its Charter is mandated so support regional cooperation in South Asia. Beyond the country programs, ADB has recently laid the ground for a broad range of large and quite significant investment operations in the region. ADB's Multi Modal Transport De-

velopment RETA to the South Asian Association for Regional Cooperation (SAARC) has drawn up investment opportunities for all the major existing and emerging economic corridors linking the South Asian economies of overseas markets. Under SASEC, ADB provided TA that established a trade and investment working group and has followed up with assistance for establishing other working groups for transport, IT and tourism development. In SASEC the planned operation includes support for transport logistics and trade facilitation which will be particularly beneficial for connectivity in the border areas between Nepal, Bangladesh and eastern India.

Table 4: Priority Initiatives

Initiatives	Activity by Implementation						
	Capital	Operations	Regulation	Public	PPP	local private	foreign private
Customs/border procedure agreements		X	X	X			
Trade and transit treaties		X	X	X			
Inland container services and port systems	X	X	X		X		
Supply chain/ logistic corridors	X			X	X		X
Trade and Investment funds for SMEs	X				X	X	X
Export market access funds for LDC and remote regions	X			X			
Export capacity building technical assistance fund	X			X			
Trade and SME hub infrastructure, with spoke collection systems ¹	X	X	X	X	X	X	X

¹ Such hub and spoke infrastructure would for instance include collection, auction, processing, packaging, testing, quality control, traceability, bio-security systems and e-trade facility infrastructure.

Table 5: Benefits and Risks Associated with the Initiatives

Initiatives	Benefits	Risks
Customs/border procedure agreements	Lower trade costs, improved security and revenue collections	Failure to diminish corruption
Trade and transit Treaties	Diversification of trade	Weak implementation
Inland container Services and port systems	Improved security, improved timeliness and quality of service	Insufficient competition and volume
Supply chain/ logistic corridors	Move to higher value added products, improved connectivity	
Trade and Investment funds for SMEs	Improved access to finance for exporters; higher supply capacity and faster technology upgrading	Insufficient returns to investments
Export market access funds for LDC and remote regions	Increased integration into a diverse set of value chains, and higher number of trading partners	Long-term sustainability of efforts
Export capacity building technical assistance fund	Increased entrepreneurial pool, access to knowledge networks in value chains	Long-term sustainability of efforts
Trade and SME hub infrastructure, with spoke collection systems	Focused, efficient investment and development, reduced trade costs, higher connectivity, move to higher value added products, access to knowledge networks	market compatibility, concentrated development

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Background
Paper for the Philippines
Appendix 3

Prepared by Department of Trade and Industry, Philippines
September 2007

PHILIPPINES

AID for TRADE PROGRAM: PRIORITIES FOR ACTION

Brief Introduction: Why aid for trade matters for RP?

- The main goal of the WTO Aid for Trade program is to help build the supply side capacity and trade infrastructure in developing countries so that these countries can increase their exports, integrate more with the rest of the world and benefit more from liberalized trade and market access.
- The Philippine experience of liberalization especially in the latter 1980s and the 1990s has not been resoundingly successful. The Philippine manufacturing sector performance exemplifies the highly mixed impact of trade liberalization in the country. For while there was a dramatic shift in the composition of Philippine exports towards manufactured products during the 1990s, the manufacturing sector barely contributed to the overall employment situation (indeed, its share to the total declined during the decade) and to poverty reduction in the country.
- With very few exceptions (most notably the semiconductor industry), most of Philippine agriculture and manufacturing declined in international competitiveness during the 1990s as indicated by measures of revealed comparative advantage. The rise in the share of exports to the national output hides the sharp narrowing of the export base of the country; thereby limiting the beneficial effects to the country of liberalized trade especially in manufactures.

Elements of the Aid for Trade Program for the Philippines: PROMOTING COMPETITIVENESS AND ENHANCING EXPORT CAPABILITY

Clearly, the country needs to improve its international competitiveness and export capacity if it has to benefit more from liberalized trade and manage better the challenges of globalization and deeper economic integration in the region. There is a whole range of initiatives that the country needs to do in order to significantly improve its international competitiveness and its export capacity. Many are related to improving the country's investment climate and to reducing the cost of doing business. The initiatives range from strengthening the structural foundations for macroeconomic stability to improving physical infrastructure to regulatory reform to effect greater contestability and efficiency especially in the country's logistics and utilities sector to improving human capital in the country to streamlining processes and procedures in investing, trading and the conduct of business to industry-specific action plans. The Aid for Trade program focuses only on a limited set of initiatives, with a greater emphasis on capacity and institution building where the private sector and the local government units can play a bigger role and on strengthening trade support infrastructure especially for SMEs.

The elements of the Aid for Trade program for the Philippines are as follows:

- **INVESTING IN WORKERS SKILLS AND DECENT WORK FOR COMPETITIVENESS.**
This is because of the comparatively high wages in the country relatively to countries

like Vietnam and Indonesia as well as wide parts of China. Human capital and updated capital facilities will have to be the country's recourse in order to raise productivity substantially and to further industrial upgrading, thereby reducing the unit cost of production and raise the country's export competitiveness. Worker skill development and upgrading capital equipment would need to be complemented with improvements in the work environment, an important element of decent work.

- **INITIATIVES FOR IMPROVED COMPETITIVENESS OF LOCAL FIRMS, STRENGTHENING SUPPORT SYSTEM AND ENHANCING ENTREPRENEURIAL SKILLS FOR SMES.** The foundations of a country's export competitiveness are the small and medium enterprises which comprise the overwhelming share of all establishments in the country. Joint private sector-government-donor community initiatives to upgrade and strengthen the country's SMEs help deepen the country's export capacity and international competitiveness.
- **STRENGTHENING CAPABILITY TO SET AND MEET STANDARDS AND CERTIFICATION FOR EXPORTS.** Exporting necessitates meeting international standards. With increasingly stringent sanitary and phytosanitary standards abroad, it is important that more and more domestic firms meet international standards and that the domestic infrastructure for testing, certification and accreditation is improved.
- **ENHANCING ECONOMIC AND TECHNOLOGICAL INTELLIGENCE AND TRADE PROMOTION.** An important element of export orientation is deeper understanding of the dynamics and evolution of the various export markets. This calls for investments in economic intelligence, esp. of interest to SMEs and government agencies. Similarly, SMEs can improve their competitiveness through strategic technology search, transfer and adaptation. A program of technology intelligence with especial reference to global patents can contribute to this technology search and transfer of SMEs.
- **IMPROVED LOCAL GOVERNANCE, PROCESSES, AND ACCOUNTABILITY TO IMPROVE COMPETITIVENESS AND INVESTMENT CLIMATE.** LGUs play an important role in improving the country's investment climate and in engendering the growth of enterprises, especially small and medium enterprises. The province of Bulacan is a good example of good and facilitative local governance contributing to improved investment climate and the growth of SMEs. Expanding the Bulacan experience to other provinces in the country would help improve the country's international competitiveness, export capacity and the capability of the country to manage the challenges of globalization.
- **ENHANCED TRADE FACILITATION MEASURES.** An important component of the Aid for Trade Program for Philippines is trade facilitation both in the national and the regional levels. The e-Customs project, a bid to modernize, computerize and streamline the customs processes for a single-window transaction, is an excellent example of this concerted effort with the objective of the time needed for documentation and meeting regulatory requirements in order to facilitate increased trade.

INVESTING IN WORKERS SKILLS AND DECENT WORK FOR COMPETITIVENESS

TWO KEY ASSUMPTIONS:

CONTINUOUS, EXPANDED AND UPGRADED SKILLS DEVELOPMENT NEEDS TO BE A MAJOR ELEMENT OF RP COMPETITIVENESS AND DEVELOPMENT STRATEGY. The growing comparative advantage of the Philippines lies in the skills of its workforce and the country's overall human capital.

PRIVATE-PUBLIC-DONOR PARTNERSHIP IN ADVANCING SKILLS UPGRADING AND SKILLS CERTIFICATION IMPORTANT. The partnership with the private sector is important because it forces the training schemes to be client oriented. It is also important that the private sector feels that it has stakes in the programs; hence, the private sector needs to foot part of the bill for the skill upgrading program. The donor also plays a role through the provision of expert trainers and lecturers, as well as financial support for top notch equipment and facilities.

Elements:

- Expand and deepen “talent development” in fast growing, skills short industries; e.g., BPO/KPO. Includes short courses for “near hires”, partnership with universities and colleges,
- Industry-led, academe-linked, and gov't co-financed specialized skills development, teachers'/trainors training, curriculum development, and competency assessment and skills certification program.
- Donor co-funding in the provision of up-to-date training facilities and equipment, linkage to specialized foreign expertise and evaluation, and support to local-foreign joint ventures in specialized skills programs
- Special industry focus on ICT-based, engineering- and design-intensive industries; e.g., BPO/KPO, creative industries, ship building, electronics and automotive, furniture/leathergoods/garments

INITIATIVES of IMPROVED COMPETITIVENESS of LOCAL FIRMS, ENHANCING ENTREPRENEURIAL SKILLS and SUPPORT SYSTEM FOR SMES

The objectives are (a) to develop participating local SMEs to become internationally competitive suppliers and sub-contractors of participating MNCs and large domestic enterprises, similar to Singapore's Local Upgrading Program, and (b) to generate a bigger number of efficient SMEs in priority industries that can help develop local production networks or industrial clusters. The emphases of intervention are on technological upgrading and technology transfer for participating firms selected as potential subcontractors/suppliers to MNCs and large enterprises, improving production and operational efficiency of SMEs, entrepreneur-

ship and management training and support services, and credit/leasing support for technology upgrading of the SMEs.

- Strengthen and expand local subcontractor/vendor/supplier program of/with large enterprises and MNCs. An example of this is the subcontractor development program of Manila Water Corporation.
- Production line improvement assistance and best practices. This is a program to develop a core of engineers and production specialists who can help SMEs address production related problems to optimize their production and improve productivity. The focus is on a few priority sectors (and possibly areas) to jumpstart the program.
- Industry-government-academe partnership for expanded and continuous technical assistance in product design and development, business counselling, entrepreneurial training, financial management, and marketing to SMEs in priority industries/clusters.
- Strengthen entrepreneurship development programs such as Ayala Foundation's "3-day entrepreneurship boot camp" as well as entrepreneurs' support services such as Ayala Foundation's SOOB which is a menu of services designed to provide technology start ups with a package of assistance and support to ease their initial formation and nurture their growth.
- Strengthen and expand private sector – led network of business incubator business support facilities/areas. Example: Ayala TBI (Technology Business Incubator) Network.
- Strengthen and expand private sector-community joint ventures based on resources, e.g., ecotourism ventures with indigenous communities
- Expand long term less collateral-based credit and leasing for capital expenditures for technological upgrading of SMEs. One major complaint of small enterprises is the inadequacy of long term credit that does not heavily rely on collateral since they tend to be collateral short. As a result, small firms are constrained to expand when demand increases due to lack of financing.

STRENGTHENING CAPABILITY TO MEET and MONITOR STANDARDS and CERTIFICATION FOR EXPORTS

Increasingly, it is standards that are the barrier to exporting. Expanding the export base would mean more and more firms need to meet international standards. It also means that the domestic certification process and institutions are acceptable internationally in order for the certifications to be recognized. This initiative is to upgrade standards and strengthen the domestic capacity for certification and accreditation.

- SPS Laboratories and Standards
 - Nationwide program to upgrade standards, develop and upgrade selected strategically located laboratories for SPS compliance for target industries/products

- Enhance accreditation program for GMP/HACCP and Halal for food industry
- Support for regular specialized training of personnel of SPS laboratories and standards setting and monitoring institutions

ENHANCING ECONOMIC AND TECHNOLOGICAL INTELLIGENCE AND TRADE PROMOTION

This initiative is related to knowing export markets and to market exports better. These are important support services for effective exporting. At the same time, technological upgrading of SMEs can include understanding more about patents and making full use of expiring patents internationally for possible technology transfer and adaptation.

- Economic Intelligence.
Comprehensive system of economic and commercial intelligence gathering, processing, and efficient storage for companies, gov't agencies and NGOs
 - Training and practice development on a system of economic and commercial intelligence gathering and techniques for strategic government agencies and foreign posts. Developing an effective data base system. Computerization of database and research facilities strategically located in NCR and the regions.
- Technological Intelligence.
Uniform system to gather technological intelligence, technology transfer, processing and efficient storage for SMEs and gov't agencies
 - Develop a database on patents and a program for technology assessment and transfer to SMEs
- Trade Promotion
Getting back and known in export after a decade of being left out requires more than low pricing, which the firms in the country can ill-afford given the high domestic production cost and the tight margins in exporting. What is likely important is more focused marketing and trade promotion, especially for market niches of low volumes but high values rather than high volumes and low prices. This is likely the Philippine market positioning for many manufactured products. This would require more intensive trade promotion at least initially as the Philippine firms get the foothold back in the export market.
 - develop a database system, monitoring process, updating and quality control on Philippine exporters and export products. Market matching initiatives.

IMPROVED LOCAL GOVERNANCE, PROCESSES, AND ACCOUNTABILITY TO IMPROVE COMPETITIVENESS AND INVESTMENT CLIMATE

It is increasingly acknowledged that local government units can play significant roles in improving the domestic investment climate, engendering the growth of domestic enterprises, and reduce the cost of doing business. The province of Bulacan exemplifies the best practice in local governance, with substantial beneficial effects on the local businesses and investments. This initiative is to expand the best practices in Bulacan to the other important economic centers in the country, especially the Luzon Urban Beltway and Cebu. Most of the local government units in these areas are also progressive and are undertaking their own improvements. This initiative is primarily to accelerate the process and harmonize policies and procedures in the selected areas in order to generate timely and quality service to the people.

- Reinventing Public Service and Performance Management System.
 - Improvement of systems and procedures,
 - computerization of government transactions,
 - incentive reform to professionalize the bureaucracy, and
 - local participation in planning and budgetingBusiness Regulation and Licensing
 - Streamlining of critical gov't frontline services thru virtual (online) inter agency network

- Investment Promotion and Facilitation
 - Strengthening and networking LGU investment promotion centers/ units
 - Local branding
 - Regular review of investment climate and business performance
 - Databank/knowledge management

ENHANCING TRADE FACILITATION

The National Government's efforts to improve and enhance existing trade facilitation in the country are noteworthy. This is aligned with concerted efforts to align with the trade facilitation programs of the ASEAN region. Proposed trade facilitation measures are also in the national pipeline to streamline and optimize existing processes for trade. These existing initiatives, and the planned and proposed additional trade facilitation measures require adequate national and government funding, international support and ODA for effective and implementation in all regions of the country, specifically those directly involved with regional and international trade. It must be noted that the EU and the United States have been actively supporting financially and through technical knowledge transfers, these trade facilitation measures such as the modernization and computerization of customs, aka the e-Customs project.

- Philippine National Single Window – is the implementation of a system of operations of the major information sharing network for customs and shipping port agencies. The network, called the National Electronic Single Window, is actually part of an international Single Window Project of the ASEAN
- ASEAN Single Window - hopes to improve the import/export and customs operations in the 10 member-countries of the ASEAN. Each of the member countries will have to implement their internal Single Window and ultimately connect each other for more efficient import and export processing. This is expected to be completed by 2012
- E-Customs Project - The Project aims primarily to enhance and upgrade BOC's core and support ICT systems nationwide. Through Internet-based and wireless technologies, it will streamline imports and exports processing and improve trade facilitation between BOC and its stakeholders, including other government agencies.
- National Economic Intelligence Framework – a comprehensive proposal to provide the infrastructure for Economic Intelligence as previously discussed. This refers to an electronic database system that will allow effective and intelligent information gathering, cataloguing and data management, storage and information dissemination.

Background Paper on the Pacific

Appendix 4

Prepared by the Pacific Department of the Asian Development Bank
September 2007

Executive Summary

What is the best trade policy for the small Pacific states to follow? Some have joined the multilateral liberalization through the WTO (World Trade Organization). Some have engaged in sub-regional trade agreements. All FICs (Forum island countries) have negotiated a FIC-only trade agreement in the form of PICTA (Pacific Island Countries Trade Agreement). There is also SPARTECA (South Pacific Regional Trade and Economic Cooperation Agreement), the non-reciprocal, preferential agreement with Australia and New Zealand. Negotiations are soon to conclude on an EPA (Economic Partnership Agreement) with the EU; and negotiations will soon begin between the FICs and Australia and New Zealand on what could be a comprehensive agreement covering other areas as well as goods trade under PACER (Pacific Agreement on Closer Economic Relations).

A trade agreement among small developing states, such as PICTA or the MSG, is unlikely to be welfare-enhancing. In fact, it is more likely to set back the promotion of free trade within the FICs because of the propensity for trade diversion and tariff and investment diversion to the more advanced states, resulting in income divergence and increased antagonism against free trade.

A trade agreement between the small Pacific states and a large developed country(ies) would be much more likely to be welfare-enhancing because the risks of trade diversion outweighing trade creation effects are much less likely. While both the EU (through the EPA) and Australia and New Zealand (through a negotiated PACER agreement) offer the Pacific countries development assistance in various forms, including trade facilitation, an agreement with Australia and New Zealand is likely to generate greater benefits for the Pacific states because the EU is a minor trading partner and looks likely to remain so. However, the 'hub-and-spoke' problem of investment going mainly to the EU or to Australia and New Zealand will affect both. Still, the intensity of the Pacific's trading relationship with Australia and New Zealand should mean much larger net benefits from a PACER agreement than from an EPA. Further, with effective trade facilitation, particularly to overcome quarantine barriers, the large potential for agricultural exports to Australia and New Zealand can be realized.

Trade liberalization with the rest of the world is likely to be most beneficial policy for the Pacific states to follow, whether done unilaterally or through joining the WTO. Unilateral liberalization would mean that the costs of being a WTO member would not be incurred. However, unilateral liberalization would mean that the protection of the WTO against WTO-inconsistent practices by WTO members would not exist. Still, a problem with joining the WTO is the preferential Special and Differential (S&D) treatment accorded to developing member states. S&D treatment in the form of assistance with trade facilitation or trade policy development is a positive measure. S&D treatment allowing slower reductions in protective barriers against imports or lower reductions in tariffs are not really favors as they only support government efforts to retain costly trade interventions.

Once it is identified as an important policy change, the most important issue that arises with respect to trade liberalization is the identification and removal of the binding constraints to its adoption. These may be institutional, economic policy-related, or cultural, among others,

including the opposition of vested interests. Within the Pacific, opposition to open markets is very strong and is supported by vested interests, ideology, and cultural beliefs. There are also economic issues constraining the response to changes in the terms of trade through trade liberalization, such as insecurity of tenure and poor access to credit. Limitations on market access may also constrain exports but quarantine restrictions on agricultural exports and domestic import restrictions that raise the costs of exporting are much more important.

A concern frequently raised by those in opposition to trade liberalization is the loss of tariff revenue because of the reduction or elimination of tariffs. However, studies have shown that the possible loss of tariff revenue is generally tiny. Alternative government revenue sources such as a VAT or excise taxes on “sin” goods such as alcohol and tobacco are to be preferred to tariffs because they are less economically distorting and less regressive than tariffs, and in the case of excises on “sin” goods can have beneficial social effects.

As far as the future of Pacific exports is concerned, the future appears to lie mainly in the development of niche markets, whether this is in tourism, ICT-related services, labor services, manufactured goods, and even agriculture. Tourism is the ultimate niche market, as all countries have some unique characteristics. Where international airline services have been opened up, resort hotels are given secure leasehold tenure to custom land, there is openness to foreign investment, and the necessary infrastructure is provided, Pacific island countries are beginning to see tourism driving economic growth. The Pacific countries have been hamstrung in developing ICT-related activities because of the way in which this sector has been monopolized. However, ICT monopolies are being removed in some countries with positive results for the export of services.

Because of their low levels of investment, rapid growth in working-age populations, and particularly in the mini-states the limited resources for the development of formal employment opportunities outside government, the export of labor services to high-income countries will be a significant activity in Pacific economies for many years to come. However, exporting labor services cannot make a large contribution to reducing unemployment and underemployment in the larger Pacific countries. These countries have to meet the challenge of developing an encouraging environment for investment if they are to see substantial increases in formal employment. The Pacific countries are trying to have temporary labor movement included in the EPA. But the EU has so far shown no interest in agreeing to this. On the other hand, the prospects for including temporary labor services in a PACER agreement are beginning to look more promising.

Aid for trade (A4T) has become a topical issue in recent times and appears to be essential in helping some developing countries make the most of the market access that has been or will be provided through trade agreements. Of particular interest for Pacific countries is trade facilitation to assist them in overcoming the quarantine and quality barriers to their development of niche agricultural export markets in Australia, New Zealand, and the US. Potential also exists elsewhere for these exports as in Japan and the EU.

ADB has been considering the place of A4T in its activities. An important point to keep in mind is that A4T should not be considered in isolation from ADB's other activities. If assistance is given for A4T, it should be because it is a priority when judged against all other pos-

sible forms of assistance. While it is very important to recognize that binding constraints to supply responses to changes in the terms of trade should be overcome, care should be taken in translating this realization into ADB programs. Identification of the binding constraints to economic growth should be essential to setting priorities for all of ADB's activities. If A4T is essential for overcoming binding constraints to a country's economic growth, A4T should receive priority. The question for ADB management should be whether addressing these constraints is a priority for the ADB, or whether another development agency is in a better position to provide the assistance.

Introduction

This report summarizes the issues raised with respect to trade policy in Pacific developing member countries (PDMCs) in earlier ADB Pacific Studies Series reports (ADB 1998, 1999) and discusses recent developments in trade policy and trade matters of interest to the PDMCs. Recent developments in trade policy of interest to the PDMCs include: (i) the Pacific Island Countries Trade Agreement (PICTA), a preferential trade agreement covering merchandise trade between Pacific island countries, which was signed in 2001; (ii) the Pacific Agreement on Closer Economic Relations (PACER), an agreement between the 14 Forum island countries and Australia and New Zealand, which was signed in 2001; (iii) the World Trade Organisation (WTO) Doha Development Round, which commenced in 2001; and (iv) negotiations over the Economic Partnership Agreement with the EU, which commenced in 2001.

Matters of particular interest to the PDMCs, some of which are closely tied in with negotiations over these various trade arrangements include the so-called 'labour mobility' issues, including the Temporary Movement of Natural Persons under the WTO's Mode IV of trade in services, and temporary employment of unskilled Pacific workers in Australia and New Zealand; as well as the possible inclusion of trade in services in the PICTA and PACER agreements. Other issues discussed below include the declining value of existing preferential trade agreements, 'aid for trade', constraints on market entry, particularly sanitary and phytosanitary (SPS) barriers, the great proliferation of bilateral and regional trade agreements, and the increasing importance of tourism for the PDMC economies and related issues such as the opening-up of international and domestic airline services.

Summary of earlier ADB analyses

ADB (1998) outlined some general theoretical relationships between trade policy and economic growth. In the seminal Solow-Swan neo-classical economic growth model (Solow 1956, Swan 1956) there is no trade and growth takes place through factor accumulation and exogenous technological change. Extension of the neo-classical model to include trade increases the level of income and has a temporary impact on the growth rate (Srinivasan and Bhagwati 1980).

In the endogenous growth models, creation of new knowledge and technology as outcomes of profit-seeking activity becomes the source of long-run growth (e.g., Romer 1990). These models also allow government policies to affect the long-run growth, for better or worse. In

this report it was argued that the standard ‘spillover’ endogenous models, with their focus on scale effects and high-growth sectors, have little relevance for PDMCs. Instead, PDMCs were urged to remove obstacles to foreign investment, as this would lead to enhanced human capital and introduction of productivity and growth-improving technology. Openness to international trade also increases the exposure of the economy to market forces and exerts pressure for the adoption of institutions (such as property rights) and policies (such as trade, investment, and competition policy) that will foster a more market-oriented and less risky environment for investors. Because of the resulting reduction in the risk-adjusted rate of return on investments, the share of value-added available for labor will increase. Increased import competition can also serve as a ‘back-door’ means of reforming labor markets, as the removal of the bargaining over the monopoly rents of protection will lead to increased labor productivity.

The ADB (1999) report went into more detail of trade policy reform in the PDMCs, given the increased attention to a trade agreement among the Forum island countries (FICs)¹ and between the FICs and Australia and New Zealand. Also, the possibility of a WTO-eligible regional agreement with the EU was being considered.

The report argued that the chances of a preferential trading agreement among the FICs being on balance welfare-enhancing were slim unless there was substantial relaxation of import barriers with the rest of the world. This is so because the likelihood of trade diversion is high, as free trade among the FICs would divert trade from lower-cost imports from the rest of the world to higher-cost imports from other FICs—leading to the development of internationally uncompetitive enterprises. It is likely that the most diversified of the FIC economies would be the major beneficiaries of the agreement, i.e., Fiji and Papua New Guinea.

A preferential trade agreement between the FICs and Australia and New Zealand would be more likely to be welfare-enhancing because imports from Australia and New Zealand would be closer to world-best prices. However, many products imported by the FICs would not be least-cost. Therefore, unilateral liberalization by the FICs with the rest of the world would be most welfare-enhancing in terms of improvements in allocative efficiency, as this would minimize the import ‘tax’ on exports (i.e., import barriers raise the costs of import-competing and exporting activities). As well, there would be the even more important ‘dynamic’ gains from trade due to openness to investment, technology, skills, and ideas.

One concern over trade liberalization addressed by the 1999 report was that reducing import restrictions, particularly tariffs, would mean a substantial reduction in government revenues unless replacement sources of revenues were found. Moreover, putting in place a new tax system would take some time. Another concern addressed was that resources moving out of industries losing protection would move out of the country, given the region’s proclivity for labor and capital to emigrate. On the first point, the report argued that compliance with payment of customs duties in developing countries is generally poor because of the extensive

¹ The 14 Forum island countries are: Cook Islands, Fiji, Federated States of Micronesia, Kiribati, Nauru, Niue, Palau, Papua New Guinea, Republic of Marshall Islands, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Together with Australia and New Zealand, they form the Pacific Islands Forum.

use of exemptions granted as favors to businesses; as well, there are the problems of customs officers miss-classifying imports to reduce duty rates and importers under-invoicing to avoid duties. The report noted that movement to a lower and less variable duty regime can lead to revenue collections not falling by as much as anticipated because there is less incentive for such discriminatory behavior.

However, reductions in tariffs could still pose a problem for government revenues and the phasing of Samoa's reforms were cited as a good example to follow. Samoa introduced its value-added tax (VAT) regime several years before it introduced its substantial trade liberalization, by which time the VAT regime was well bedded down.

On the second point, the report argued that there is likely to be a good case for institutional reform at the same time as trade policy reform to reduce the likelihood of resources leaving the country. Resources are invested in protected industries because, in large part, the monopoly rents granted by the protection means that their return on investments is high enough to more than offset the risks of investing in the country. Therefore, in order to reduce the investment risks and the rate of return required for investors to want to invest, it is necessary to improve the investment climate.

The report concluded that unilateral liberalization would be the best option for the PDMCs. It argued that the PDMCs could act "as if" they were members of the Asia Pacific Economic Cooperation (APEC) grouping or members of the WTO, without having to bear the high administrative costs of being a formal part of these organizations. However, it has to be recognized that being a member of the WTO has advantages in coping with trade disputes with other members. For example, as shown below with regard to the FICs developing agricultural export industries, quarantine barriers pose a considerable obstacle and often these restrictions are not genuine.

Trade agreements among small, developing countries

In 2001, the FICs negotiated a preferential trade agreement, the Pacific Island Countries Trade Agreement (PICTA). It is purely a merchandise trade agreement with tariff reductions phased in over a long period—up to 10 years for the least developed FICs and 13 years for the three FICs that have a Compact of Free Association with the US. Negative lists were allowed; and these are very extensive in some cases (e.g., Papua New Guinea). Protection of 'developing' industries is also allowed, as are safeguards, such as anti-dumping measures, for balance of payments reasons. PICTA was signed by nine FICs in 2001 and came into force in 2003. However, to date only Cook Islands, Fiji, and Samoa have national legislation in place and are ready to trade under the agreement.

PICTA was seen as a "stepping stone" towards more multilateral trade liberalization. The idea that trade liberalization should be a gradual process to limit disruption and structural adjustment was uppermost in the minds of the parties to the agreement. However, the lack of progress in implementing the agreement suggests that seeing PICTA as a "stepping stone" to further liberalization may be a highly optimistic assessment. Moreover, the perception that the agreement could be a "training ground" for businesses and governments completely misunderstands the political economy of trade reform.

The FICs are mostly very small economies with similar exports (mostly agricultural) and little trade between them. The empirical studies that have been undertaken show that the benefits from PICTA would be minimal.¹ Moreover, there is the strong possibility that the outcome of the agreement could be negative on balance because of the high likelihood of trade diversion. That is, the preferential removal of tariffs on higher-cost imports from member countries would allow them to displace lower-cost goods previously imported from countries outside the bloc.² As noted earlier, trade diversion effects would be less likely if the bloc lowered its barriers to trade from the rest of the world.

The adverse impacts of this kind of trade agreement are likely to be even worse than envisaged above. The governments of the importing countries no longer receive tariff revenues from the imports that come from within the trade bloc. Essentially, the tariff revenue is transferred in large part to the exporting firms in member countries and to some extent to domestic consumers. As we have seen from experience with the collapse of the East African Community and the problems encountered in the attempted formation of the customs union among the Caribbean states, the more advanced of the developing country grouping tend to receive most of the investment generated by the new trading bloc and therefore receive most of the “transfer” of the tariff revenue. Hence, it is likely that the more industrially-developed of the FICs will benefit from PICTA at the expense of the others. The same forces that cause trade diversion also lead to income divergence between the members of the trade bloc. The outcome is likely to be antagonism against trade liberalization in these countries, setting back progress towards trade liberalization. So, rather than being a “stepping stone” towards fuller trade liberalization, PICTA is likely to be a “stumbling block”.

Trade liberalization is not a popular policy in PDMCs and is strongly resisted by state-owned enterprises (of which there are many in most PDMCs) and by the branches of international companies that have been set up under import protection mechanisms; as well as by most NGOs, which apparently do not see that in resisting trade liberalization they are in fact supporting the use of very regressive taxes and punishing potential export industries. Hence, with this set of forces arrayed against trade liberalization, if it is to progress it must be given the best chance. Introducing trade liberalization through PICTA appears to be the worst option to take.

Those not in favor of trade liberalization under PICTA, or under any other agreement for that matter, often cite the loss of tariff revenue as a reason for not adopting such policies. As noted above, preferential trade agreements do transfer tariff revenue between countries within the trade bloc. Because of the concerns over the loss of tariff revenue, the Pacific Islands Forum Secretariat (PIFS) recently commissioned a report on the likely tariff revenue loss by the eight smaller FIC members (FSM, Kiribati, Nauru, Niue, Palau, RMI, Tonga, and

¹ See, for example, Robert Scollay, J. Gilbert and D. Collins, *Free Trade Options for the Forum Island Countries*, Report prepared for the Pacific Islands Forum Secretariat, Suva, 1998.

² As opposed to trade creation where, because of the lowering of trade barriers between countries within the trade bloc, lower-cost partner country imports displace higher-cost domestic production.

Tuvalu).¹ The report reviewed conclusions from previous studies in the light of recent trade information, and looked at effective mechanisms for recovering the loss in tariff revenue due to the adoption of PICTA. It was concluded that PICTA would mean only a minor loss of tariff revenue (less than 2% of government revenue), which could be easily covered from other revenue sources such as from increased “sin” taxes and use of VAT.

The above criticisms also hold for sub-regional preferential trade agreements such as the Melanesian Spearhead Group (MSG); which was originally formed between Papua New Guinea, Solomon Islands, and Vanuatu, and later included Fiji and New Caledonia. This trade agreement began with three commodities being granted free entry (one for each country) and over the years the number of commodities included in the agreement has grown to over 160. However, it appears that whenever a domestic industry believes that its market is being taken by imports there is an appeal for protection against the imports—an appeal that is usually granted. Hence, in recent years, there has been the “tinned beef war” between Papua New Guinea and Fiji, the “biscuit war” and the “kava war” between Fiji and Vanuatu. The unwillingness of these governments to abide by the trade agreement illustrates the lack of conviction at political level in the region about the benefits of trade liberalization.

The most important actions that the Pacific island countries could take as a group would be to realize the economies of scale and other benefits from adopting the regionalization measures proposed under the Pacific Plan. These would be much more effective than any Pacific country-only trade agreement. Besides achieving economies of scale, regional bodies that provide public goods (such as a competition policy body or regional audit or customs authorities) would have a much larger pool of skills to draw from; as well, regional bodies should achieve a measure of independence from the “small country” problems that these countries face in trying to implement the checks and balances that lead to good governance.

Trade agreements with large developed countries

As members of the Pacific Islands Forum, the PDMCs have begun to engage with large developed countries in negotiations over regional trade agreements such as the ongoing negotiations over an Economic Partnership Agreement (EPA) with the EU and the upcoming negotiations over a PACER agreement with Australia and New Zealand.

PACER

PACER is a framework agreement that established the guidelines for the future development of trade relations among the 14 FICs and with the two developed country members of the Pacific Islands Forum, Australia and New Zealand. It also touches upon trade agreement negotiations with the EU and the US. In a sense, PICTA is the first agreement to be established under PACER. Under PACER, negotiations over a preferential trade agreement between the FICs and Australia and New Zealand were to commence eight years after PICTA came into force (that is, 2011). However, negotiations may begin earlier by mutual consent or if they are triggered by the FICs commencing negotiations over preferential trade agreements with

¹ Pacific Islands Forum Secretariat, *The Potential Impact of PICTA on Smaller Forum Island Nations*, (prepared by the consultants, Institute for International Trade and Pacific Trade Consult), June 2007.

other developed countries, such as the EPA negotiations with the EU.

In providing a framework for the gradual development of trade and other economic cooperation among the FICs and between the FICs and other countries, PACER acknowledges that individual FICs may find it in their interest to move at a different pace in developing closer integration with other countries. This provision was affirmed in a recent speech by the Australian Foreign Minister, Alexander Downer, who stated:

The Pacific Agreement on Closer Economic Relations (PACER) holds the prospect of a comprehensive, region-wide free trade agreement. But there may be some countries that would like to develop their relationship with Australia at a faster rate and in ways that go beyond the scope of PACER.

To encourage even greater commitment to good governance and economic growth in Pacific countries, we might be able to strike bilateral agreements with particular countries to give them more support in return for a greater commitment to reform. Simply providing more aid money will not solve the Pacific's problems, but we should support real reform efforts.

Such agreements would set clear targets for economic and governance reforms. In return, we would offer opportunities for greater economic integration with Australia.

Under the agreements we could provide more aid targeted at economic growth or, in some cases, the establishment of trust funds. We could offer assistance with attracting investment and promoting trade; help Pacific countries meet Australian import requirements for their export products; and provide assistance with infrastructure projects that help build the capacity to trade.

We would also look to place more Australian officials in advisory or line positions in the public service in Pacific countries to help plan and implement the agreed reforms.

The conclusion of such agreements would send a strong signal to the region about our commitment to the Pacific and our strong support for real reform.¹

This can be read as an open invitation to the FICs, on an individual basis, to begin negotiations—with Australia at least—over an agreement for close economic relations that go beyond merchandise trade and could involve trade in services and freer labor movement, as well as development assistance of various kinds. There is already provision within PACER for Australia and New Zealand to provide financial and technical assistance for the establishment of trade facilitation measures for the FICs.

According to modeling work undertaken, a preferential merchandise trade agreement between the FICs and Australia and New Zealand offers many times larger net benefits to the

⁵ In Fiji's case, its sugar exports to the EU account for more than 80% of its total exports to the EU.

island countries than does PICTA (e.g., see CIE 1998). The additional gains largely flow from lower-cost imports displacing higher-cost domestic production in the PDMCs. With the structural adjustment away from inefficient industries, displaced resources flow towards activities that reflect the countries' comparative advantage. Besides the structural adjustment impacts on the previously protected labor and capital, the key concern is the ability of the economies to respond to the changes in relative prices. This response will depend largely on whether there are internal constraints to the supply response. Hence, it is critical that, as part of the trade liberalization, policymakers identify and remove any binding constraints on responses to the relative price changes. These binding constraints may be in the form of institutional, policy, and regulatory obstacles, as well as economic obstacles in the form of human capital and credit access constraints.

Because of the large share of Australian and New Zealand imports in the total imports of most FICs, a preferential trade agreement between the FICs and Australia and New Zealand will have significant impacts on the customs duties collected by those FICs that impose tariffs. As Narsey (2003) has argued, however, the FICs can protect a substantial part of their government revenues collected from this source by converting import duties to excise taxes on "sin" (alcohol, tobacco) and luxury goods (such as luxury cars), and raising the level of taxes on these goods—in the case of the former for health reasons and for equity reasons in the case of the latter. For those countries that do not presently have a VAT, introduction of this form of taxation, which is usually less regressive than a tariff regime, could also help to compensate for any revenue loss.

A Pacific Economic Partnership Agreement (EPA)

Negotiations between the EU and the Pacific ACP (PACP) states over an EPA were to begin in 2002 and to conclude by 31st December 2007. This deadline was set in the trade provisions of the Cotonou Agreement, the replacement for the Lome IV Convention, signed in 2000. Whereas the preferential, non-reciprocal provisions of the Lome Convention were found to be incompatible with the provisions of GATT Article XXIV, the regional EPAs between the EU and the ACP countries were to be reciprocal agreements. However, even with the deadline for the end of negotiations over the EPAs looming, almost no progress has been made on an EPA with the PACP countries.

Both Scollay (2002) and Narsey (2003) note that the EU is an insignificant source of imports for most PACPs and conclude that it is likely to remain so. For example, the EU's share of Fiji's total net imports is around 2%. Therefore, providing free entry to EU imports is not significant in itself. The important point is that providing such preferential entry will trigger demands for similar preferences to Australia and New Zealand under PACER and to the US under the Compact agreements. However, of the Compact countries, this would only be of concern for Marshall Islands as FSM and Palau have tariff levels close to zero.

The main trade issues for the PACPs in the EPA negotiations are Fiji's exports under the Sugar Protocol with the EU, the export of canned tuna—which currently concerns Papua New Guinea, Solomon Islands, and Fiji, but other PACPs are investing in tuna canning facilities—and the temporary employment of vocationally-skilled workers in EU countries. Be-

cause they have such little interest in exporting to the EU in the absence of preferential arrangements, the PACPs have focused on the export of labor services—an export activity that is not so affected by the high international trade costs of these remote countries. The other major interest for the PACPs in an EPA is the provision of development assistance that the EU has promised under the Cotonou Agreement.

The Common Agricultural Policy of the EU is being reformed under pressure from within the EU and from the WTO and the preferential price that has been granted to ACP countries for their quota of sugar exports is being reduced. Similarly, the margin of preference on canned tuna is to be reduced. These reductions in import preference will lead to significant adjustment pressures in these industries within the PACPs. In requesting quotas for the temporary entry of workers with skills such as in the hospitality industry, nurses, and those with skills such as carpenters and plumbers, the PACPs are attempting to broaden the definition of GATS (General Agreement on Trade in Services) Mode IV “temporary movement of natural persons”, which presently covers only highly-skilled workers such as doctors.

To date, the EU has shown no interest in including the temporary migration of such workers in the EPA. Largely as a result, the negotiations over a Pacific EPA are stalled. With the end-2007 deadline near, consideration is now being given to what might take place in the absence of a negotiated EPA. One option is for the EU to apply to the PACP imports the Generalised System of Preferences (GSP) tariffs that apply to all developing countries. There are three levels of tariffs under the GSP: the standard tariff that applies to all developing countries; the Everything But Arms (EBA) regime that applies to countries identified by the UN as Least Developed Countries (presently Kiribati, Samoa, Solomon Islands, and Vanuatu: Samoa will shortly lose its LDC status) and which allows duty-free and quota-free access to imports; and the so-called GSP+ regime, for which no ACP states are eligible. Under a GSP regime the product of main concern is canned tuna, where Fiji and Papua New Guinea would have to export to the EU on the same basis as other developing countries. Solomon Islands would have preferential status. However, a major problem with the PACP countries being given access to the preferential GSP or EBA regimes is that these arrangements are not reciprocal. The developing countries are not required to undertake any trade liberalization. In that event they will continue with policies that prevent them from participating in the trade and economic growth that comes from economic integration with the rest of the world.

Other options in the absence of an EPA by end-2007 are to request an extension of the WTO waiver or to agree on an EPA with only a generalized framework identified and for detailed negotiations to be concluded later. The extension of the WTO waiver is unlikely because of the lack of sympathy for the EU from other WTO members, on the basis of setting a bad precedent. It may therefore be best for the PACP countries to agree on an EPA by the end-2007 deadline, which leaves open negotiations on the transition arrangements for sugar and tuna and the possibility of temporary employment of workers. This would provide the countries immediate access to the development assistance (including assistance with trade facilitation) promised by the EU on condition of the adoption of sensible economic policies.

But this kind of agreement would only show up the fact that the EPA and PACER agreements are being negotiated in the wrong order. The large gains from trade liberalization—and the large structural adjustments, except for the Fijian sugar industry—will be associated with the

PACER negotiations. Also, as the PACER agreement stipulates, and Minister Downer's recent statement affirms, there will be development assistance available, including assistance with trade facilitation, as a consequence of the PACPs adopting economic policies that will promote economic growth. The negotiations over the economic policies to be adopted by the PACPs in exchange for various forms of development assistance are likely to be more detailed under the PACER negotiations; and therefore it would appear desirable to negotiate these arrangements first before turning to the EU for requests for development assistance.

Multilateral trade liberalization

Presently, Fiji, Papua New Guinea, Samoa, Solomon Islands, and Tonga are members of the WTO. However, their accession has been negotiated under the usual WTO preferential practice of allowing developing countries to maintain higher tariff levels and reduce them more slowly than is the case for developed countries. By liberalizing their trade with the rest of the world through the WTO, the Pacific countries would gain improved market access without transferring tariff revenue to Australia and New Zealand or to the EU. Accession to the WTO also 'locks in' the commitment to trade liberalization because the WTO provides both sanctions and rewards (technical and financial assistance to improve human resource capacity and assistance with policy development). PICTA does not provide this means of overcoming the time inconsistency problem that subsequent governments will not follow the same policy, as there is no sanction and rewards regime in PICTA. The WTO also provides protection against actions taken by member countries that are not WTO-consistent.

The transaction costs of accessing the WTO are relatively high, particularly for small countries. However, the transaction costs of negotiating EPA have been high and they will be high for negotiating a preferential trade agreement under PACER. Small countries could gain most of the benefits of WTO membership without joining the organization through unilateral trade liberalization. However, they would not have access to the financial and technical assistance available through the WTO. Also they would not have access to the kind of protection provided by the WTO dispute resolution mechanism. However, the favorable 'Special and Differential' treatment that developing countries receive within the WTO does not really do them a favor, as it only serves to prolong the costs that they are incurring through having distorting import restrictions in place. Trade liberalization is not the reason that some low-income countries are falling further and further behind in relative per capita income terms. The reason for their poor performance is in large part because they are not liberalizing their trade and are marginalizing themselves from developments in the rest of the world.

Ultimately, the negotiation of a preferential trade agreement between the FICs and Australia and New Zealand and with the EU will involve the exclusion or restriction of some of the exports in which the PICs have a comparative advantage. It is often the case that preferential trade agreements between high-income countries and developing countries allow free access for all commodities except those that the developing countries are best at producing. For example, under SPARTECA (South Pacific Regional Trade and Economic Cooperation Agreement), Australia allows free entry to all exports from Fiji, except for sugar, which is banned. Beef exports from Vanuatu, its premier export, are subject to an EU quota. Thus the chances for the FICs to gain free access for their exports are likely to be better in a WTO negotiation than in a bilateral negotiation with a developed country.

Bilateral agreements with developed countries also hold the threat noted with regard to PIC-TA: that investment will tend to concentrate in the most advanced country. This is the so-called 'hub and spoke' problem where the 'hub' country, in this case the high-income country(ies), is the focus for investment as it has preferential access to all the 'spoke' countries.

Discussions on topical trade issues

Below, several recent developments affecting the economies of the PDMCs and topical trade issues are discussed in an examination of what they might mean for trade policy and economic development in the PDMCs. These topics include the recent growth of tourism in the Pacific, the growth in overseas employment by Pacific islanders, health and food safety issues with respect to agricultural exports, and the concept of 'aid for trade'.

Tourism in the Pacific

Tourism has become a more and more important sector in Fiji, especially as the sugar industry has withered as the result of the non-renewal of land leases to Indo-Fijian farmers by the indigenous landowners, and with the sharp decline in the garment industry because of the loss of preferential entry to the US due to the expiry of the Multi-fiber Arrangement and the decline in tariff assistance given to the garment industry in Australia and New Zealand. The Fiji tourism sector was set back sharply by the 1987, 2000 and 2006 coups. However, it quickly recovered from the 1987 and 2000 coups, and will recover again once political stability is restored. The tourism industry in Fiji has no doubt been assisted by the impact of the Bali bombings, especially affecting Australian tourists, and by the SARS scare. However, the industry has also benefited from increased competition in international air services to Fiji and by the reasonably secure, long-term leases provided to resort hotels.

More recently, the tourism industry has become a key economic growth driver in other Pacific states, particularly Cook Islands, Samoa, and Vanuatu. The surge in tourist numbers in these countries has been most noticeable since 2004, coinciding with the period in which international air services to these countries became more competitive. But again, the existence of secure, long-term leases of custom land for resorts, openness to foreign investment, and privatization of hotels in the case of Cook Islands, has been very helpful. Interestingly, Cook Islands, Samoa, and Vanuatu were the PDMCs that undertook comprehensive economic reform programs in the mid-1990s with the assistance of the ADB. A general point that can be made from the growth in tourism is that it illustrates the importance of niche markets for these economies that have such high international trade costs. After all, tourism is the ultimate niche market. All countries have some unique characteristics that they can highlight to differentiate their tourist 'product'.

What does the growing importance of tourism for PDMCs mean for their trade policies? For those PDMCs that have not yet taken advantage of this opportunity, there is a clear message. Open up international air services (and most likely internal transport services), provide effective airport infrastructure, provide resorts with secure long-term land tenure and develop equitable contracts with landowners, and be open to foreign investment.

Most PDMCs do not have a high absorption capacity for waste and therefore environmental considerations will always limit manufacturing. Hence, besides agriculture and fishing, service activities will be high priority areas for exports. For example, provision of education and medical services are likely developments. A critical element in developing some services export is to have an efficient telecommunications sector. The PDMCs have been hamstrung for many years in the development of telecommunications-related activities because of the monopolistic arrangements most of them put in place. Fortunately, these monopolies are being dismantled in several countries with spectacular results. For example, Samoa now has several ISP providers and has opened its mobile phone sector. As a result, internet and mobile phone use has expanded rapidly. Fiji is in the process of opening up its mobile phone and internet sectors.

Exporting labor

In the past when populations outstripped the capacity of the land to feed the people, Pacific islanders set out in search of new islands to settle—which they obviously did very successfully. They are no longer able to do that because sovereignty has been declared over all the land on the planet. Moreover, population growth was much slower in those days than over the past 50 years or so, during which time the world's population has experienced very rapid growth as the result of a unique set of events: safer water and sanitation and immunization against infectious diseases leading to lower infant and maternal mortality and longer life expectancy. Today, Pacific populations are increasing at annual rates of growth as high as 2.5-3.0 per cent. In the absence of substantial investment in the communally-owned land there is no possibility of agricultural productivity increasing at anywhere near this rate in order to maintain per capita food consumption. But unless special arrangements are made, in a communalistic society there is an absence of secure individual title to land, an absence of savings, and little or no capacity to borrow, and therefore little incentive for entrepreneurship, investment and individual effort.

The increased food demand from the increasing populations has to be satisfied by increasing the farmed area. Otherwise, people have to leave the village to try to find work in the towns or to work overseas. In a sense, therefore, Pacific peoples are still “on the move”. In Tonga, for instance, remittances comprise over 50 per cent of Gross National Income. The share is about 20 per cent in Samoa and it is growing rapidly in Fiji. It is estimated that 90% of Cook Islanders live overseas. Much the same holds for the micro-island states of Niue, Nauru, Tokelau, and Tuvalu. Thus, most of the people from these small, remote communities live and work elsewhere and are educated with this objective in mind. They regularly send remittances to their families and church; moreover, they return on holidays frequently; and some eventually return permanently when they retire. People from the US Compact countries have free movement into the US.

But the same is not true for the larger Melanesian countries—Papua New Guinea, Solomon Islands, and Vanuatu—that do not have easy migration access to Australia, New Zealand and the US. In these countries, literacy rates are significantly below those in the Pacific countries with relatively easy access to metropolitan countries. Parents do not have the incentive to educate their children, as they cannot migrate and there are few job opportunities within the country.

However, pressures are building for allowing temporary immigration for employment for even these countries. Two effects are at work. First, there is the ageing of populations in the higher-income countries. Moreover, with their incomes increasing, people in these countries are less inclined to do the “3D” work (dirty, difficult, and dangerous). Second, there is a ‘youth bulge’ in the Pacific island countries, especially Kiribati, Papua New Guinea, Solomon Islands, and Vanuatu, countries in which formal employment is very low and growth of formal jobs is very slow. Because of these two effects, there should be a happy coincidence of interests between the high-income countries of the Pacific region and the Pacific countries. New Zealand, which has long allowed free entry of people from Cook Islands and Niue and relatively liberal entry of migrants from Samoa and Tonga, is trialling a temporary, seasonal, unskilled worker scheme for labor from Vanuatu, as well as from Samoa and Tonga. Australia is said to be observing how this scheme progresses.

Where migration is possible, Pacific Island people educate their children to migrate to market-based societies. In most cases, they perform just as well economically as the rest of the population of the host country. They send back remittances to their families and for village celebrations and other obligations. That is, they retain strong links to their village community, and are thus able to return when they wish. Most of the smaller Pacific Island countries are unlikely ever to be so economically viable that they will be able to support growing populations. Therefore, they will continue to need outward migration and financial support from their relatives working overseas or from foreign aid that provides for essential infrastructure. Outward migration seems to be a necessary dimension of their future. This does not mean that the migrants lose their identity or the cultural values of their communities. In fact, they will have the rich opportunity to enjoy the best of both worlds, returning for holidays or when they retire.

For the larger Pacific states such as the Melanesian countries, labor mobility can still be important, as it is presently in Fiji. However, it is unlikely to play as important a role as in Samoa and Tonga, or in the mini-states. For the larger Melanesian countries, ensuring private investment of sufficient scale to create employment opportunities that match the numbers of high school and tertiary education graduates will remain their biggest challenge.

With respect to the interaction between labor mobility and trade policy, the PIFS is trying to generate enthusiasm for the inclusion of trade in services, particularly labor services, into the PICTA, PACER, and EPA agreements. As far as PICTA is concerned, most of the Pacific island countries have little to offer each other with respect to making a deal on merchandise trade or services trade. If labor was free to move within PICTA countries, the same effect as mentioned earlier is likely to be observed; that is, skilled people will move to the more advanced countries, contributing to the present ‘brain drain’. The EU has so far expressed no interest in including provision for temporary employment of semi-skilled migrants in the Pacific EPA. The best opportunities for Pacific labor mobility appear to lie with Australia and New Zealand within the PACER framework.

Aid for trade (A4T)

In the 6th WTO ministerial meeting held in Hong Kong in December 2005, an Aid for Trade (A4T) Initiative was proposed. The main objective of the Initiative is to provide A4T assistance to countries as a parallel measure to support the WTO Doha Round. The rationale

for A4T is that some developing countries need assistance to take advantage of the market access opportunities offered to them as the result of the Doha and previous WTO Rounds. In recent years there has been a realization that the supply response of many developing countries to the opening of markets in the higher-income countries has been poor and that this is often due to supply constraints ('binding constraints') within the country. Unless these obstacles are overcome the countries will not be able to take advantage of the market openings in other countries.

Assistance of this form appears eminently sensible. For example, the Pacific island countries have not been able to participate in the virtual revolution in exports of high-value agricultural products that has occurred in recent years (see McGregor 2007). McGregor's paper highlights a very important issue in the development of Pacific agriculture: overcoming the sanitary, phytosanitary (SPS), and quality barriers facing agricultural exports into developed country markets. McGregor points to the unrealized market opportunities for Pacific agricultural products in the substantial Pacific Islander populations residing in countries such as New Zealand, Australia, and the US. He noted that there are also unrealised market opportunities for unique PIC products elsewhere, such as in the EU and Japan.

Overcoming the SPS barriers requires scientific data to demonstrate that the importation of PIC agricultural products does not pose a threat to the importing countries' agricultural sector; or to demonstrate the kind of quarantine treatment that will be most effective in rendering the imported products harmless, without reducing their quality. Besides the scientific input needed, the PICs have to gain the attention of the potential importing countries in order to carry on effective negotiations over market entry. Because of the Pacific islands' relatively small size, gaining the importing countries' attention is difficult. Trade facilitation of this form appears necessary if agricultural exporting is to have a place in the economic development of the PDMCs.

What does this concern for A4T mean for the ADB's activities? While it is very important to recognize that binding constraints to supply responses to changes in the terms of trade should be overcome, care should be taken in translating this realization into ADB programs. Identification of the binding constraints to economic growth should be essential to setting priorities for all of ADB's activities. If A4T is essential for overcoming binding constraints to a country's economic growth, then obviously A4T should receive priority. The question for ADB management should be whether addressing these constraints is a priority for the ADB, or whether another development agency is in a better position to provide the assistance.

Thus, ADB management should not be considering whether to establish a special mechanism to address A4T issues. If A4T is considered to be a priority issue for the PDMCs or other member countries, then it should take priority in the Bank's overall assistance program.

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- 206. Debapriya Bhattacharya
Economist, Center for Policy Dialogue (Bangladesh)
- 207. Peter McCawley
Visiting Fellow (Economics Dept, /RSPAS), The Australian National University
- 208. Federico Macaranas
Faculty, Asian Institute of Management
- 209. Rene Ofreneo
Director, University of the Philippines School of Labor and Industrial Relations
- 210. Isidro Antonio Asper
Executive Assistant on External Affairs to the FFW President
Federation of Free Workers (Philippines)
- 211. Ariel Castro
Director for Education, Trade Union Congress of the Philippines
- 212. Glenn Ymata
Tambuyog Development Center (Philippines)
- 213. Ashok Desai
Consultant Editor
Business World

- 214. William Jr. Pesek
Journalist
Bloomberg
- 215. Raphael Minder
Correspondent
Financial Times

Selected Media Participants

- 216.ABC 5
- 217.ABS-CBN
- 218.Agence France Presse
- 219.Agencia EFE
- 220.Al-Jazeera TV
- 221.Ang Pahayagang Malaya
- 222.APTN
- 223.Asahi Shimbun
- 224.Associated Press
- 225.Bandera
- 226.Bloomberg
- 227.Business Mirror
- 228.BusinessWorld
- 229.Daily Manila Shimbun
- 230.Daily Tribune
- 231.Deutsche Press Agentur
- 232.Dow Jones Newswires
- 233.DZBB

234. European Pressphoto Agency

235. Financial Times

236. Fuji TV

237. GMA-7

238. GMAnews.TV

239. Guangming Daily

240. IBC 13

241. Inquirer.net

242. Jiji Press

243. Kyodo News Agency

244. Manila Bulletin

245. Manila Standard Today

246. Manila Times

247. Net 25

248. Panay News

249. People's Journal

250. Philippine Daily Inquirer

251. Philippine Chronicle

252. Pilipino Star Ngayon

253. Radyo ng Bayan

254. Reuters

255. Straits Times

256. Tempo

257. Thomson Financial

258. Tokyo Shimbun

259. Veritas Asia

260. Xinhua

261. Yomiuri Shimbun

Asian Development Bank

262. Haruhiko Kuroda, President

263. Phil Bowen, Executive Director for Australia

264. Howard Brown, Executive Director for Canada

265. Patrick Pillon, Executive Director for France

266. Sebastian Paust, Executive Director for Germany

267. Ashok Lahiri, Executive Director for India

268. Ceppie Kurniadi Sumadilaga, Executive Director for Indonesia

269. Masaki Omura, Executive Director for Japan

270. Saad Hashim, Executive Director for Malaysia

271. Wencai Zhang, Executive Director for People's Rep of China

272. Kyung-Hoh Kim, Executive Director for Republic of Korea

273. Marita Magpili-Jimenez, Executive Director for the Philippines

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284. Aw Siew-Juan, Alternate Executive Director
285. Richard Stanley, Alternate Executive Director
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317. Klaus Gerhaeusser, Deputy Director General
318. Sultan Hafeez Rahman, Deputy Director General
319. Xianbin Yao, Deputy Director General
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321. Jaseem Ahmed, Director
322. John Cooney, Director
323. Barry Hitchcock, Director
324. Shireen Lateef, Director
325. R Keith Leonard, Director

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330. Rita Nangia, Director
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332. Ashok Sharma, Director
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335. Bart Edes, Head
336. Thomas Crouch, Country Director
337. Edgar Cua, Country Director
338. Arjun Goswami, Country Director
339. Ayumi Konishi, Country Director
340. James Nugent, Country Director
341. Jean-Pierre Verbiest, Country Director
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343. Misuzu Otsuka, Advisor to the President
344. Sungsup Ra, Advisor to the Managing Director General
345. Georges Heinen, Senior Advisor
346. Lesley Lahm, Senior Adviser
347. Masato Miyachi, Senior Advisor
348. Antonio Andrea Monari, Senior Advisor
349. Vusala Jafarova, Director's Advisor

- 350. Harry Kuma, Director's Advisor
- 351. Johan Dubois, Director's Advisor
- 352. Than Hoo, Director's Advisor
- 353. Chris Grewe, Director's Advisor
- 354. Andrew McSkimming, Director's Advisor
- 355. Darinchuluun Bazarvaani, Director's Advisor
- 356. Torben Bellers, Director's Advisor
- 357. Rizwan Bashir Khan, Director's Advisor
- 358. Takeshi Murazawa, Director's Advisor
- 359. Mitsunori Motohashi, Director's Advisor
- 360. Sinate Mualaulau, Director's Advisor
- 361. Wantanee Wanapun, Director's Advisor
- 362. Chang Huh, Director's Advisor
- 363. David Jay Green, Advisor
- 364. Robert Boumphrey, Advisor
- 365. Noy Siackhachanh, Advisor
- 366. Jeffrey Liang, Principal Country Economist
- 367. Daan Boom, Principal Knowledge Management Specialist
- 368. Tomomi Tamaki, Principal Country Economist
- 369. Bruno Carrasco, Principal Economist
- 370. William James, Principal Economist
- 371. Ying Qian, Principal Economist (Financial Sector)
- 372. Stephen Polard, Principal Economist

373. Tsukasa Maekawa, Principal Media Relations Specialist
374. Jacques Ferreira, Principal Regional Cooperation Specialist
375. A. Barend Frielink, Principal Regional Cooperation Specialist
376. Christophe Bellinger, Principal Guarantees and Syndications Specialist
377. Ashraf Mohameed, Senior Counsel
378. Yumiko Tamura, Senior Country Economist
379. Sharad Bhandari, Senior Economist
380. Hans-Peter Brunner, Senior Economist
381. Giovanni Capanelli, Senior Economist
382. Donghyun Park, Senior Economist
383. Ganeshan Wignaraja, Senior Economist
384. Hasib Ahmed, Senior Investment Specialist
385. Chiemi Jamie Kaneko, Senior Financial Market Specialist
386. Yushu Feng, Senior Regional Cooperation Specialist
387. Mahfuz Ahmed, Senior Agricultural Economist
388. Jiro Tsunoda, Senior Financial Market Specialist (Capital Markets)
389. Xinning Jia, Senior Project Management Specialist
390. Hiroki Kasahara, Regional Cooperation Specialist
391. Cuong Minh Nguyen, Regional Cooperation Specialist
392. Mohammed Parvez Imdad, Operations and Administration Specialist
393. Joven Balbosa, Country Specialist (Philippines)
394. Anjum Ibrahim, Country Specialist
395. Sunniya Durrani Jamal, Operations Specialist
396. Kelly Bird, Economist

- 397. Ronald Antonio Butiong, Economist
- 398. Tadateru Hayashi, Economist
- 399. Jong Woo Kang, Economist
- 400. Anna Charlotte Schou-Zibell, Economist
- 401. Sona Shrestha, Economist
- 402. Lei Lei Song, Economist
- 403. Pradeep Srivastava, Economist
- 404. Kenji Takamiya, Economist
- 405. Hsiao Chink Tang, Economist
- 406. Norio Usui, Economist

