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Economic Integration in East Asia: Cambodia's Experience

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In the last five decades, the world has witnessed dramatic changes. The Cold War has ended, and geopolitical relations among the major powers have been generally stable and tranquil. Moreover, the end of colonialism has allowed newly independent countries to play a greater role in the international arena, and countries that used to be foes have now joined hands to develop their economies and raise the living standards of their peoples. At the same time, economic integration, both regional and global, has taken a strong hold. There is a growing realization that, for the survival of the modern world, with increasing cross-country links and externalities, global cooperation is a necessity. The economic and business climate has changed remarkably. Countries not necessarily sharing political ideologies have come together to benefit from mutual interdependencies, and small nations are resorting to regionalism to enhance their bargaining leverage and to gain some degree of international political influence. Countries integrate because they do not want to lose out in the global competition for export markets and foreign direct investment (FDI). Moreover, they also realize that their lives and economic options are being determined not only by themselves, but by an international environment over which they have little control, and that the inherent risks are best minimized through group and not individual country action.

The pace of international economic integration accelerated in the 1980s and 1990s. The sweep of economic reform and spectacular economic growth in China and the commitment to market-based reforms by India have added fuel to this process. Moreover, the establishment of the World Trade Organization (WTO) in 1995 has created a favorable environment for settling multilateral international trade issues in an amicable manner. As a consequence of these developments, hundreds of global, regional, and bilateral integration processes have emerged, and many of them have taken root. The number of regional trade agreements notified to the WTO from 1995 to May 2003 was 265 (though not all are in force). The Association of Southeast Asian Nations (ASEAN), a regional trade agreement established in 1967, has slowly gained momentum and has made considerable progress in forging a regional free trade area. ASEAN aims to achieve a fully integrated ASEAN Economic Community by 2020.

The rapid progress of economic integration has sparked an intense debate over the advantages and disadvantages. While it is more or less clear that integration would bring about stronger economic growth, it is less clear whether the economic benefits of this growth would be equitably distributed to reduce poverty. Strong economic growth may help reduce poverty only if the poor benefit from it. The opponents of integration argue that integration is a guise for exploiting the people in developing countries, which will cause massive disruptions of lives and few benefits to the poor. Others consider it with hostility and believe that it increases inequality within and between nations, threatens employment and living standards, and thwarts social progress in the weaker economies. The proponents point to the significant reduction in poverty in countries that have adopted economic integration, such as China, India, and Vietnam. Others consider this integration as a key process for future world economic development. They believe it is inevitable and irreversible.

Since the mid-1980s, Cambodia has gradually moved away from a planned economy to a market-based economy supported by a wide range of economic reforms and increasing

involvement in regional and global integration activities. Cambodia is a small economy, and, to benefit from economies of scale, we have to be competitive in export markets. After many years of effort, Cambodia has succeeded in becoming a member of ASEAN and the WTO. In spite of its narrow economic base, it is carrying out the major structural adjustment of the economy required by these affiliations. We realize that Cambodia has no choice but to be integrated with the world community to survive in the evolving global environment. The pain we are suffering today is in the interest of the long-term development of Cambodia.

This essay outlines many perspectives on economic integration, particularly in the context of East Asia, and uses Cambodia as a case study in evaluating the merits and demerits of integration. The essay will begin by discussing the strengths and weaknesses of economic integration from global and regional perspectives and then analyze the impacts of economic integration on Cambodia. Finally, the essay will provide some thoughts on how best to manage the risks implicit in the rapid changes in the economic structure resulting from integration.

Key perspectives on economic integration

Economic integration may be interpreted in several ways. In a broad sense, it may be considered identical to globalization, which might be defined as increasing economic interdependence among countries. In this essay, "economic integration" and "globalization" will be used interchangeably. At a more technical level, economic integration may be defined as the rise of international trade through cross-country links in the markets for goods, services, and some factors of production. The increasing role of FDI, multinational corporations, and international capital markets in supporting higher growth, higher employment, and the exports of several countries reflects some of the tangible outcomes of economic integration across the globe.

In general, economic integration is expected to provide a slew of benefits to consumers. It would result in lower consumer prices because of increasing allocative efficiency through production structures based on comparative advantage, the exploitation of economies of scale in the bigger domestic and international markets, and the adoption of new technologies. As a consequence of expanded consumer choices because of greater quantities and ranges of imports and exports, more competition, the dismantling of vested monopolies in domestic markets, higher productivity growth, and lower price markups, the average consumer in a country will be more well off with more trade rather than with less.

The poor might also conceivably benefit from the growth of international trade. At least, they would benefit as consumers from lower prices. Additionally, there is evidence that greater economic integration has played an important role in accelerating growth and reducing poverty in an increasing number of developing countries and, hence, in reducing overall global inequality in income distribution. Three channels have been identified as contributing to reducing poverty. First, economic integration promotes growth, which will have significant trickle-down effects. Second, the higher demand for relatively abundant factors of production, such as unskilled labor in most of the Asian countries, will improve the incomes of the poor. Third, the use of better technology will raise productivity and, consequently, factor incomes.

Another major benefit from economic integration is good governance. The failure of governance can lead to an overall political breakdown. Weak governance has contributed to the poor economic performance of several countries. Globalization has put a high premium on good governance. An increasingly competitive global marketplace leaves little room for corruption, which adds to transaction costs. As a result, governments are rendered more accountable to their

citizens for the higher costs of economic mismanagement. Globalization has also raised new challenges for public policy that go beyond halting corruption. Technological gains, shifting geopolitics, expanding trade and financial flows, and cheaper communications have created tremendous opportunities and lifted barriers to global knowledge and problem solving. They have likewise raised new risks and challenges, for example, financial instability, disease transmission, and crossborder criminality. Nations will have to adapt their political and governance institutions to the new technological, financial, and economic realities. This is also a challenge.

Alongside the benefits, economic integration is thought to create many problems. Oxfam (2000) critiques globalization as antigrowth and antipoor because globalization ignores the crucial role of income distribution in poverty reduction. The poor have virtually no access to productive resources. Since economic integration benefits only those with resources, people who lack resources, typically the poor, are left behind. Therefore, globalization has contributed to a growing divide between the haves and the have-nots.

The distribution of per capita income between countries has become more unequal in recent decades. For example, in 1960, the average per capita gross domestic product (GDP) in the richest 20 countries in the world was 15 times that in the poorest 20 countries. Today, this gap has widened to 30 times since rich countries have, on average, also grown more rapidly than poor ones. Indeed, per capita incomes in the poorest 20 countries have hardly changed since 1960 and have even fallen in several countries. Moreover, the hopes of some of the poorest countries that the demand for low-skilled labor will increase once a country has opened up may not be realized because low-skilled labor may no longer be needed following the introduction of new technologies.

Job insecurity may also result from globalization. In the developed countries, integration will provide job security to those with the skills and mobility to exploit opportunities in global markets, while low-skilled workers will be left out because their jobs and earnings will be displaced by labor-intensive imports from low-wage countries or shifted overseas by multinational corporations to reduce costs. On the surface, it appears that unskilled and semiskilled workers in developing countries have benefited from integration through improved employment prospects and higher earnings, as there is more FDI. However, this apparent benefit is also at risk since globalization exposes these economies to business cycles that originate in the developed world. Moreover, the investments of multinational corporations are often fickle. They have no permanent stake in any country and tend to relocate production facilities to emerging centers of competitive advantage. Overall, labor in the developing world experiences no less job insecurity than their counterparts in the developed world. Moreover, recent evidence shows that trade liberalization leads to growing wage gaps between the educated and uneducated not only in the countries of the Organisation for Economic Co-operation and Development, but in the developing world as well. Between 1991 and 1995, wage gaps increased for six of seven Latin American countries for which reliable wage data are available. It was inevitable that this led to massive social protests in these countries.

Another major problem of economic integration is the stress it places on the scarce administrative resources of governments in the less developed countries. The world has become increasingly borderless, and governments have lost control over many areas of public policy management. With financial integration, nation states have lost part of their sovereignty and control to capital markets and speculators driven by the profit motive and not by considerations of public good. Technological advances and the lowering of border barriers have increased the

problems involved in monitoring and controlling crossborder crimes such as commercial fraud, drug and human trafficking, money laundering, environmental pollution, and terrorism. And, while integration raises the demands for governments to provide social safety nets, it reduces the ability of governments to provide these nets because governments are discouraged from raising taxes on the capital and earnings of skilled labor, the main beneficiaries of globalization.

The most serious charge against economic integration is that it was the primary cause of the 1997–98 Asian financial crisis, which brought to an abrupt halt the smooth economic progress regional economies had been making for more than a decade. The crisis showed that regionally integrated economies might be quickly affected by a contagion arising from the economic weakness of one country in the group. Thus, economic integration may cause volatility and vulnerability in some countries due to no fault of their own.

The crisis also showed that excessive reliance on foreign capital to support higher economic growth is a high-risk strategy. Short-term capital inflows to Southeast Asia were massive in the early 1990s mostly by way of private sector commercial bank borrowings and portfolio investments. The inward surge of capital occurred in response to the strong economic growth, capital account liberalization, and domestic financial market liberalization witnessed in these countries. In the six quarters preceding the onset of the crisis in July 1997, capital inflows into Indonesia, the Republic of Korea, the Philippines, and Thailand totaled US$86.8 billion. However, in the subsequent six quarters, there was a huge outflow of US$77.9 billion. These funds were largely utilized for domestic purposes and were, by and large, not hedged against exchange rate risks. The pegged exchange rate provided an implicit government guarantee against exchange rate risk, spurring domestic borrowers to access the cheaper international funds. The huge capital inflows contributed to overvalued exchange rates, asset bubbles in real estate and stock markets, overinvestment in productive capacity, and falling quality in investment projects. Short-term debt was used to finance longer-term investments, resulting in risky maturity mismatches. When the crisis struck, foreign capital fled, and regional currencies depreciated sharply. Since the size of the foreign funds was huge and exceeded official reserves, central banks were unable to defend their currencies in most cases. Even though the affected economies have, by and large, adjusted since the shock, some effects of the crisis are being felt even today.

The last argument against economic integration is the threat of social disintegration. Economic integration is perceived to undermine traditional values and cultural identities because of the increasing intrusion of global, primarily Western, norms, practices, and values into societies and local communities. The Internet has increased the rapidity and ubiquity of this process. The change has been so rapid in several countries that centuries' old domestic institutions, norms, and practices have fallen by the wayside in the name of economic progress.

East Asian economic integration

Even though it seems to be a mixed blessing at best, countries in the region are keen to go forward with economic integration. Economies such as Hong Kong (China), Korea, Taiwan (China), and the original five ASEAN member countries (Indonesia, Malaysia, the Philippines, Singapore, and Thailand) opened up a long time ago to trade and investment. They have become well integrated with the world economic community. Indeed, a major goal of ASEAN is to foster this integration. The new ASEAN members are also eager to join the world community. In fact, Cambodia, the Lao People's Democratic Republic, and Vietnam opened up their economies even before they gained ASEAN membership. Overall, Asia has become a dominant supplier to

consumers in developed economies. The East Asian countries were able to expand their share of global trade from 5.4 percent in 1975 to 18.7 percent in 2001, while their share in manufactured exports increased from 52 percent in 1981 to 88 percent in 2001.[1]

However, East Asian countries wish to strengthen economic integration since they realize there is no viable alternative growth strategy to sustain growth momentum in the future. The ASEAN countries have started to put in place the structure for the ASEAN Economic Community, while the East Asia Vision Group has proposed the formation of an East Asian Economic Community that will include the 10 ASEAN member countries, plus China, Japan, and Korea. The proposal to create this economic community has been boosted by the creation of the East Asia Summit. The rationale for the community is that some of the economies in the group are too small to be able to participate effectively in the global market, and they need to integrate with the large economies in the region to enhance the benefits from economic cooperation and integration.

Recent economic research reveals that integration has been naturally motivated by market forces, economic complementarity, and the economic dynamism of the region. However, this process has been impaired because of the Asian financial crisis and the failure of the WTO world trade talks at Cancun in September 2003. Therefore, it has been recognized that strong government support through formal regional institutional agreements will be needed to supplement market forces in accelerating integration. These developments are elaborated below.

Market-driven initiatives

Alongside rapid economic growth, there has been a notable expansion of intraregional trade in East Asia. In fact, intraregional trade has been expanding much more rapidly than the trade of the region with areas outside the region. A study by Ng and Yeats (2003) shows that, while the share of the trade of the East Asian countries increased threefold between 1975 and 2001, the intraindustry trade increased by sixfold. The share of intraregional trade in East Asia in the region's total trade rose from 23 percent in 1980 to 41 percent in 2001 (excluding Japan).[2] The increased intraregional trade and investments were a natural process of economic development because economies in close proximity tend to grow together by taking advantage of economies of scope and scale.

Moreover, within the region, the export profiles of some countries increasingly match the import profiles of others. This complementarity is strong for the group comprising Hong Kong, Indonesia, Malaysia, the Philippines, Taiwan, and Thailand, which reflects the importance of intraindustry trade and the strengthening of two-way trade among these countries. Between 1985 and 2001, the share of intraregional exports in total exports increased substantially, from 9.9 percent to 27.2 percent for Indonesia, from 10.1 percent to 34.1 percent for Korea, and from 14.8 percent to 41.1 percent for Taiwan. In the same period, the share of intraregional imports in total imports also rose significantly, from 13.8 percent to 37.3 percent for Indonesia, from 13.4 percent to 25.8 percent for Korea, and from 12.7 percent to 31.4 percent for Taiwan (see table 2.1).

The increase in intraregional trade was initially accompanied by an increase in foreign investment, which was led by Japan, in the newly industrialized economies and in Southeast Asian countries in the 1980s. Subsequently, investment from the newly industrialized economies flowed to Southeast Asia and China. In fact, the share of these countries in investment among ASEAN members continues to rise. Japan appears to be the largest investor in ASEAN countries,

especially Indonesia and Thailand. Multinational corporations began to fragment their production processes into subprocesses and locate the fragmented production facilities in countries in the region according to available national factor proportions and technological capabilities. This strategy has generated a web of intraregional trade networks in parts, components, semifinished products, and finished products within East Asia, contributing to a more efficient division of labor and deeper integration in the region. The FDI-trade nexus is a distinctive feature in the region. FDI is a complement to trade rather than a substitute for trade.

TABLE 2.1. Share of Intraregional Trade in Total Trade, 1985–2001

	Exports		*Imports*	
Country	*1985*	*2001*	*1985*	*2001*
China	35.1	30.8	23.0	49.8
Hong Kong (China)	27.5	35.2	46.8	60.0
Indonesia	9.9	27.2	13.8	37.3
Korea, Rep. of	10.1	34.1	13.4	25.8
Malaysia	38.1	42.0	44.4	51.6
Philippines	17.5	34.4	34.1	37.1
Singapore	35.1	44.9	39.2	43.5
Taiwan (China)	14.8	41.1	12.7	31.4
Thailand	25.5	33.5	33.5	36.2

Source: Ng and Yeats 2003.

Public sector initiatives

Integration in the East Asia countries has not been driven by market forces alone. Since the early 1990s, governments in the region, prompted by many motives, have played a proactive role in cementing regional economic integration.

First, the governments have had to respond to escalating pressure from a private sector clamoring for policies and strategies to facilitate trade and investment. The macroeconomic interdependence within the region has recently become stronger, as evidenced by the simultaneous contraction of economic activity throughout East Asia in 1998 and the expansion in 1999–2000. Though regional economies may be affected by some common factors, such as economic cycles in the United States and stock-price movements in the information technology sector, many of the recent, synchronized economic activities in the region can be attributed to growing macroeconomic interdependence and the recent efforts to develop a network of free trade areas in the region by ASEAN+3 (plus China, Japan, and Korea), ASEAN and the Australia and New Zealand Closer Economic Relations Trade Agreement, and ASEAN and India. The increasing interdependence in trade and investment will not be sustained if there is no formal policy support from the governments. Problems such as harmonization in rules, regulations, laws, standards, procedures, dispute settlement, and so on will need to be addressed before integration may be taken to a higher level.

Second, even though there has been strong economic growth in many countries in East Asia in the last two decades, the threat of rising poverty and unemployment remains. Regional governments cannot turn a blind eye to this issue. They must become actively involved in regional integration initiatives so that they are able to manage effectively the social and political

fallout from economic integration. This is crucial for the sustainability of economic growth and integration. It is not a coincidence that most of the poor and the people who have been left behind in these countries are located along the borders, where infrastructure is weak and social services are virtually nonexistent. Realizing this threat to the sustainability of economic integration, the governments have initiated infrastructure development and generated employment opportunities in border regions.

A notable example of shared infrastructure that forges closer trading relationships among countries with common borders is cooperation in the Greater Mekong Subregion, which includes Cambodia, Lao PDR, Myanmar, Thailand, Vietnam, and Yunnan Province and the Guanxi Zhuang Autonomous Region in China. In 1992, with assistance from the Asian Development Bank (ADB), these countries embarked on a program of regional economic cooperation to raise the standards of living of their peoples. Through the program, three major economic corridors are being developed that, when completed, will significantly boost trade and investment across the region. The Greater Mekong Subregion has emerged as a strong regional entity and one of the most rapidly growing subregions in the world.

The need for strong financial governance was highlighted by the Asian financial crisis. It is now realized that poor financial and corporate governance in the affected countries contributed significantly to the deepening of the crisis and was a direct result of government failure. There is a clear need for governments to engage in the prevention, management, and resolution of financial crises and contagion. Governments are responsible for ensuring that strong corporate and financial management structures are put in place so that there is no repeat of the 1997–98 catastrophe. The global initiative for a new international financial architecture was moving slowly when the crisis struck. The crisis-affected economies were also dissatisfied with the level of assistance from the European Union (EU) and the United States and the inappropriate conditionalities of multilateral financial assistance that treated the crisis as though it had originated from current account imbalances, while the problem was centered on capital account management. It was clear that the region had to devise self-help mechanisms to prevent and manage possible crises in the future. The creation of the ASEAN+3 process of regional financial cooperation is a direct result of the crisis. Since the crisis, economic integration has become an attractive option for sustainable economic recovery because it provides better security of market access, attracts investment resources, and creates internal pressure for domestic economic reforms and restructuring.

The failure at Cancun and the slow progress of Asia-Pacific Economic Cooperation has had serious repercussions for the economic welfare of many developing countries. While the developments in the international forums have been slow, economic integration in the Americas and Europe has strengthened appreciably. The EU is expanding rapidly by bringing erstwhile countries of the Council for Mutual Economic Assistance into the fold. The Free Trade Area of the Americas is also forging ahead. By 2003, 184 regional trade agreements in force throughout the world had been reported to the WTO. Regional governments fear that, unless they form their own free trade areas, they will be disadvantaged in global competition. Firms are being forced to adopt and adapt to regional and global strategies of doing business in order to survive and stay competitive. East Asia has been obliged to respond somehow to show the world that, even in the face of complex diversity within the region, there is an avenue for closer regional cooperation, coordination, and integration. The East Asian governments have realized that their countries will not be able to maintain the status quo in the global production network in the rapidly changing global competitive equation if there is no integration. The East Asian economies also believe

they need to secure a bigger market within their own region so that economies of scale and efficiency gains may be exploited more effectively. The region needs to establish an extensive network of regional production and trading arrangements with key economic players. This will open up and expand opportunities for economic links in the region and beyond and strengthen regional competitiveness and attractiveness globally. At the same time, closer economic integration will enhance competitiveness and bargaining leverage and offer safeguards for continued market access for exports. Obtaining all these advantages would require active government participation in regional integration processes.

Lastly, regional governments have had to respond to the severe adjustment problems emerging because of the rapid economic rise of China. However, this challenge may be converted into an opportunity. The emergence of China as a world economic power has led to a growing realization that the region might form a large and dynamic economic bloc by integrating with China, harnessing regional resources and efforts to resolve regional problems, and meeting the common challenges of regionalism from America and Europe. With China included, the East Asian region will hold one-third of the world's population, one-quarter of the world's GDP, and two-fifth of the world's foreign reserves.

Financial integration

There was a realization following the 1997–98 crisis that self-help mechanisms are needed in the region for the effective prevention, management, and resolution of financial crises and contagion. This has sparked several initiatives that should be quick in response, wide in scope, and effective in impact. Intensive policy dialogue and mutual surveillance, the establishment of regional liquidity support arrangements, and the development of bond markets denominated in local currencies are among several regional initiatives that have been launched to strengthen regional financial integration.

The East Asian economies have liberalized their financial systems to integrate them with the global financial system so that they may have better access to capital markets, especially those in the developed economies. But more efforts are needed for a better deployment of regional financial resources. Currently, a sizable portion of gross savings in Asia finds its way into debt instruments of governmental and quasi-governmental issuers in industrialized economies, while investment in Asia is financed, to a significant degree, by capital from those same countries. This reflects the relative lack of integration in financial markets in the Asian economies. Moreover, financial liberalization and innovation initiatives in East Asia do not appear to have strengthened the financial links among the financial markets of individual East Asian countries. Instead, financial liberalization has led to the diversification and strengthening of East Asian financial ties with global financial markets rather than closer financial cooperation within the region.

While individual East Asian countries have made considerable progress in deregulating and opening their financial markets, they have not been able to coordinate their liberalization efforts collectively. As a result, they have achieved little harmonization in legal systems at the regional level for the protection of minority stockholders, for regulatory systems, and for the tax treatment of crossborder financial transactions. They have achieved little harmonization in standards governing banking, accounting, auditing, disclosure, and corporate governance. Lagging cooperation in the regional harmonization of legal and regulatory systems and standard-setting has been by far the most important cause of the slow progress in financial integration in

the region.

Potential benefits of financial integration

If a deep and well-functioning corporate bond market were to become established in the region, the considerable pool of savings, much of which now flows to industrial countries, might instead be utilized within the region. As financial intermediation becomes rationalized, the cost of capital for enterprises in Asia would become lower. The dependence of regional investment on funds from nonregional sources is not only incongruous; it also exposes the region to the risk that the flows of capital might dry up abruptly because of developments in international financial markets, thus wreaking havoc on regional economic activity.

Financial market deregulation and liberalization generally facilitate the migration of capital in the long run and the crossborder financing of current account imbalances in the short run, thereby reducing the costs of adjustment to shocks. Financial liberalization also allows the extensive sharing of the investment risks associated with macroeconomic shocks across countries because it broadens the range for diversification by including foreign bonds and equities in individual portfolios. By lowering transaction costs and eliminating exchange rate risks, the formation of a common currency area can help area members reap these benefits of financial liberalization. Therefore, countries with close international financial links would have the incentive to join a common currency arrangement.

Expanding the effective size of regional financial markets through greater integration across national jurisdictions may increase the ability of our economies to absorb the volatility of international capital movements as effectively as the European and U.S. markets. Several official initiatives toward closer financial links in the region are bearing fruit, notably the Chiang Mai Initiative and the Asian Bond Fund.

Moreover, with financial market liberalization, domestic residents can diversify their asset portfolios internationally by holding securities issued by firms and financial institutions of other countries in addition to domestic ones. The possibility of portfolio diversification across a large array of assets means that a country suffering an adverse terms-of-trade shock could share some of the loss with its trading partners to the extent that it holds claims on their output.

An adverse supply shock such as an oil price increase may result in a deficit on the current account in addition to both an increase in unemployment and a decrease in real wages. As they adjust to the shock, countries with an open financial regime have better access to regional and global capital markets so that it would be easier and less costly for them to borrow to finance their current account deficits. External borrowing sourced from international capital markets at reasonable terms might make the real adjustment smaller and less arduous for these countries than recourse to higher-cost, arranged borrowings.

Current development of financial integration

While East Asian countries have been unable to coordinate their institutional reforms at the regional level, they have been pressured to adopt the codes and standards for financial sector regulation, accounting, and corporate governance developed by advanced countries. Whatever its rationale, the effort of the advanced countries to graft the Western systems and standards on East Asia has not been successful (Park 2002). East Asia has recently recognized the need to get a regional consensus on this issue, and the ASEAN+3 Finance Ministers' Meeting process has

taken it up as a high priority.

In other areas, East Asia has made significant progress in monetary and financial cooperation. This process has been led by the ASEAN+3 group in response to the 1997–98 financial crisis and has been assisted in various ways by the ADB. In its efforts to integrate their financial markets, ASEAN+3 countries have created two important initiatives, the Chiang Mai Initiative and the Asian Bond Markets Initiative. These two initiatives have been progressing well and provide major benefits to member countries.

A salient feature of the *Chiang Mai Initiative* is the provision of liquidity support to participating countries through a network of bilateral swap agreements. In May 2006, ASEAN+3 took a major step by strengthening the initiative and doubling the size of the swaps.

ASEAN+3 has also instituted a number of mechanisms to support policy dialogue and promote open discussion on financial and economic issues. It has implemented the *Asian Bond Markets Initiative* to mobilize the region's vast pool of savings for direct, efficient use in the region's long-term investments. During this period, the following has been achieved.

- Various international and foreign institutions have issued bonds denominated in local currencies. The World Bank issued ringgit-denominated Islamic Bonds in Malaysia in May 2005. In Thailand, the ADB and the Japan Bank for International Cooperation issued baht-denominated bonds in May and September 2005, respectively. These were the first baht-denominated issuances by an international institution and by a foreign government institution. In October 2005, the International Finance Corporation and the ADB issued renminbi-denominated bonds, so-called Panda Bonds, in China. The ADB also issued peso-denominated bonds in the Philippines. The proceeds of the issue will be used to buy up nonperforming loans from the National Home Mortgage Finance Corporation. The issuance of the Japanese Samurai Bonds recovered in 2005.
- Bonds denominated in local currencies have also been issued through securitization. In China, the China Development Bank and the China Construction Bank issued assets-backed securities with trust investment companies as special purpose vehicles in late 2005. In Japan, the issuance amount of mortgage-backed securities by the Government Housing Loan Corporation recorded a noticeable growth. Korea started issuing Student Loan-Backed Securities based on the loans originating through the new student loan system. In Singapore, the Commercial Mortgage-Backed Securities market is thriving in line with the real estate investment trust. In April 2006, the government supported the launch of the Small- and Medium-Sized Enterprise Access Loan Scheme.

Cambodia's experiences in globalization

Since liberation day on January 7, 1979, the government of Cambodia has been strenuously involved in rehabilitation efforts. In the early 1980s, Cambodia experimented with a centrally planned economy. Realizing the vast potential provided by the world community and FDI, Cambodia embraced a market-based economic system in the mid-1980s. Cambodia has never been hesitant to join regional and global communities. As a result, it has become a member of many regional and global organizations, such as ASEAN, the Greater Mekong Subregion, and, at the global level, the WTO. All these initiatives have meant considerable structural adjustment and reform on Cambodia's part.

Cambodia's trade with the world has also increased substantially in the last decade. Trade

has been the main source of economic growth in Cambodia. The normalization of relationships with EU countries and the United States that culminated in trade agreements has been widely hailed as a success. Cambodia has gained jobs and investments, along with better working conditions for labor. After Cambodia gained access to the European and U.S. markets, its garment exports increased in value from only around US$20 million in 1995 to almost US$2 billion in 2005. Growing employment in the garment and textile sectors has been a major factor in stabilizing the economy. These sectors currently employ 280,000 skilled and unskilled workers.

Economic growth averaged 8 percent in the last decade. This spectacular growth was made possible by sharp increases in trade and investment. Economic growth rose to 9.5 percent in 2004 and accelerated to 13.4 percent in 2005 despite negative external developments such as higher oil prices, terrorism, and the spread of epidemic diseases. Political stability, accompanied by greater investor confidence, has provided the basis for this robust growth performance, which has been driven mainly by the superb growth in the agricultural sector, the expanding tourism sector, continued robust garment exports, and increased construction activities. The growth rates in the agricultural sector, industrial sector, and services sector have generally been quite robust, from 11.7 percent, 12.1 percent, and 2 percent, respectively, in 2003 to 1.1 percent, 16.7 percent, and 10.1 percent in 2004 and 17.3 percent, 13.3 percent, and 9.4 percent in 2005, respectively.

The value of total trade has also risen significantly. The value of exports reached almost US$3 billion in 2005, while the value of imports reached almost US$4 billion. Cambodia has established trading relationships with a wide range of partners, including the EU, Japan, many other Asian countries, and the United States. At the same time, Cambodia has also received considerable foreign investment from several sources. The value of FDI rose substantially, from US$74 million in 2003 to US$381 million in 2005. The increase in trade and investment reflects the growing integration of Cambodia in the world trading system.

With around 75 percent of the population still living in the countryside and an economy heavily dependent on tourism and garment exports, the integration of Cambodia into regional and global communities, especially the entry into the WTO, is fraught with opportunities and challenges. Some skeptics have questioned the merits of Cambodia, with its vulnerable economic structure, joining the WTO. They have noted the situation of several members of the WTO that are least developed countries and that, despite their membership, have been unable to secure trading opportunities commensurate with their development needs. However, from its past experience, Cambodia remains hopeful of gaining substantial benefits from its accession to the WTO. Nevertheless, it realizes that the risks inherent in this initiative will need to be carefully managed.

Perceived benefits of integration

The perceived benefits of integration range from building a new national image within the world community to improving exports, investment, and governance. In the case of a poor country such as Cambodia, integration is seen as a necessary means to achieve economic growth. To survive in the harsh and fierce environment of global competition, Cambodia must grasp all available opportunities. Integration represents one way to guarantee we seize these opportunities.

Cambodia's recent history has been traumatic; it is still going through the aftermath of a genocidal regime, prolonged internal conflict, and neglect. The image of violence, poverty, and hardship has stuck with the country. The integration of Cambodia into the world community is

therefore viewed as a deliberate step toward breaking away from the image as a poor, war-stricken country isolated from the international community. Moreover, integration may be considered a means to fulfill broader strategic goals, one of which is to facilitate the peaceful reemergence of Cambodia as a trading nation.

Economic integration will afford Cambodia access to markets in other countries. Integration will also intensify competition between foreign and local producers. The resulting market environment will be more efficient and in a better position to cope with global competition. This, in turn, will attract more investment, creating a virtuous circle of higher productivity, higher incomes, and higher growth. Cambodia's industrial environment will eventually converge toward international norms through a reduction in the impediments to export competitiveness.

Cambodia's membership in the WTO implies that investors wishing to locate production facilities in Cambodia will not be subject to price discrimination in export markets. Moreover, Cambodian exporters will be able to know in advance the maximum legal duties that may be assessed on exported goods because WTO members have "bound" (that is, set legal ceilings on) most of their tariff lines. Furthermore, a Cambodian exporter may be assured that the exports will not be subject to quotas or quantitative restrictions on export markets. For all of these reasons, WTO membership reduces the uncertainty facing an investor who wants to produce in Cambodia for export to other markets.

Integration will also provide exporters with access to raw materials and intermediate inputs at world market prices. Cambodia has always recognized this, and, under the Law on Investment, has provided export industries with duty-free access to imported capital and intermediate goods and raw materials. For example, membership in ASEAN allows Cambodia to import fabrics from ASEAN countries to produce garments for the EU market. When Cambodia was not a member of ASEAN, it had to ask for derogation from the EU every year in order to import fabrics to produce garments for the EU market so that it might satisfy the requirements of the Rules of Origin under the EU generalized system of preferences scheme.

The ability to export with free access to raw materials and to benefit from fair and nondiscriminatory treatment in foreign markets is very important for Cambodia because it needs more exports to generate jobs. Cambodia is a small country with a relatively small population, a large proportion of which is impoverished. However, Cambodia's population has been growing rapidly. The number of young people entering the job market has been rising and will continue to rise at a rapid pace in the years ahead. Expanding employment opportunities commensurately is therefore a major challenge. Given the lack of purchasing power in the domestic economy, the rapid creation of new jobs in the short term will only result from production for external markets. Exports will play a key role in creating employment and reducing poverty in Cambodia until domestic markets are able to generate sufficient employment opportunities to absorb the growth in the labor force. Moreover, exports will allow Cambodian producers to access the world's resources, technology, and ideas, enable greater efficiency and productivity through the exploitation of comparative advantage, economies of scale, competition, and innovation, and provide for wider consumer choice.

To be able to export and generate employment, Cambodia needs foreign investment because adequate savings, skills, and technology are not available within the country. Cambodian firms must therefore cooperate with foreign firms to get the benefits of what they are missing at home. Foreign investment has an important role in upgrading technology levels and transferring commercial and industrial knowledge. Cambodia has much to learn from the foreign

firms that know foreign markets the best and possess the technology, managerial experience, and marketing channels needed to export successfully.

Cambodia's textile and garment industry well illustrates the role of exports and investment in generating employment and helping to reduce poverty. More than half the current 280,000 skilled and unskilled jobs in the industry have been created during the past five years, making the industry by far the largest source of job growth during this period. The workers are generally from low-income families in the countryside, and their earnings usually flow back to these families in the countryside, where they support rural development. Garment exports have also helped manage the balance of payments; they rose sharply from around US$20 million in 1995 to almost US$2 billion in 2005.

Cambodia understood from the beginning that the country's attractiveness to investors depends on the availability and quality of the physical and financial infrastructure required by business. The investment environment is also enhanced by the availability of an educated and trained labor force. Economic integration may be seen as an opportunity to encourage foreign investment in key services infrastructure and therefore as an opportunity to enhance the country's overall environment for business. Likewise, foreign participation in adult education and training would help develop the skilled workforce that is necessary to attract skills-based industries and allow for increased wages because of higher productivity.

The agricultural sector also stands to benefit greatly from integration. The productivity of the agricultural sector in Cambodia is considered low. Relative to neighboring countries, agricultural yields are much smaller. However, through economic integration, the small yields might also be turned into a good opportunity to enhance productivity in the sector. Because of the vast area of cultivation and the huge untapped potential in all agricultural crops, economic integration would open up foreign markets to Cambodian agricultural products, while also obliging Cambodian farmers to become more competitive so as to succeed in local and foreign markets.

Even though integration may be considered a source of inequality, the benefits from integration offset the negative impacts. Integration can act as a motivating force among people who have been left behind so that they will work harder, learn more, and equip themselves with more professional skills because they will see the benefits obtained by others from integration in terms of better living standards and greater prosperity. In Cambodia, we have realized the benefits of higher education and greater skills, and we are experiencing a huge increase in the demand in education for places both in private and public universities. Many people with lower-level degrees or diplomas have gone back to tertiary education.

Finally, integration will force Cambodia to carry out the necessary reforms in legal and institutional structures and improve governance standards. This is a major challenge. For example, WTO membership requires an intensified effort by Cambodia to put in place the legal framework required by business. For some time, the government has been actively engaged in drafting and submitting to the National Assembly the laws necessary to establish a modern, liberal, business-friendly legal environment. A member of the WTO must likewise enact laws that embody WTO rules on international trade and activities related to trade.

In terms of legal obligations, the first and most obvious challenge is to fulfill the commitments to legislative and administrative change that Cambodia has accepted through the protocol of WTO accession. In a decision taken on February 27, 2004, the Council of Ministers identified 98 separate tasks that flow from the protocol and that needed to be accomplished before the end of 2005, and it apportioned the responsibility for completing these tasks among 20

ministries and agencies. Its agreements to abide by international treaty rules and the rule of law in the conduct of trade and in domestic policy will push Cambodia to accelerate the implementation of legal and domestic policy reform, ensuring the uniform and impartial implementation of trade accords with much greater transparency and strengthening prudential regulation and supervision. However, a modern, liberal, business-friendly, and WTO-compliant legal regime will only be as good as the level of implementation and enforcement. The magnitude of the multiple challenges that Cambodia faces in this respect is widely recognized. Cambodia is at the very earliest stages in developing a properly functioning judicial system. It must push ahead with reform as a matter of urgency and, in the meantime, ensure that nonjudicial measures such as arbitration and administrative enforcement are used to the fullest to ensure that laws are put into practice and obeyed.

Negative impacts of integration

Similar to other countries undergoing integration, Cambodia is also facing several problems. Rapid economic change is altering social relationships, with some positive and some negative effects. Even though the opportunities provided by integration are substantial, Cambodia does not possess a sufficiently robust social framework to seize on those opportunities fully. It continues to experience the many social ills, such as drug use and crime, that are often attributed to globalization.

Integration will likewise mean that, in future, Cambodia will not be spared from the shocks emanating from the international financial and commercial systems. For example, the Asian financial crisis resulted in a sharp drop in FDI in Cambodia. The ratification of trade agreements between other countries will also have an impact on Cambodia, for example, the United States–Vietnam Trade Agreement. The end of safeguard measures by the EU and the United States on textile products from China in the future will also pose a threat to the Cambodian garment sector.

One of the biggest challenges relates to the rising inequality resulting from the differential impact of integration on segments within society. Those people who are not able to seize the opportunities provided by integration are being left out of the process. With its sustained high growth over the last decade, Cambodia has reduced poverty incidence from 47 percent in 1993–94 to 35 percent in 2004. The peace dividend in the aftermath of the end of civil strife and the low initial conditions prevailing in the economy have enabled Cambodia to sustain high growth during the early stages of development without severely straining capacity. This growth has generally been unbalanced, centered in Phnom Penh and other urban areas, and narrowly based, driven as it is by such activities as garment making, construction, and tourism.

Cambodia is experiencing considerable inequality in income distribution: the Gini coefficient was 0.42 in 2004. If the situation worsens because of integration, the social consequences will be heavy. This is the most pressing issue in Cambodia today. We have enjoyed economic success because of a high growth rate, but we have not been able to reduce inequality, and this may threaten stability and future growth. Cambodia is considered to suffer from the greatest inequality in income distribution in the region. Much of this has been due to growing differences within the rural population, with considerable variation in the rate and distribution of growth in different localities, in the security of land tenure, in remoteness from markets and services, and in the lack of productive assets.

Inequality in Cambodia can be classified into two kinds. First is the inequality

represented by those people with good education and financial background who are able to seize the new opportunities and the inequality represented by those people with less education who are unable to capitalize on these opportunities. In Cambodia, those who possess advanced degrees, the ability to speak foreign languages, and the skills demanded by the market are living comfortably because they are able to work for reasonable salaries in the private sector or with nongovernmental organizations and other international organizations. Meanwhile, the other people, those without skills and education, are stuck in low-paying jobs without proper medical care or a social safety net. For example, many women employed in garment factories must live at a subsistence level as they struggle to remit large shares of their wages to their families. This is not unique in Cambodia. It is a problem common to all countries. The government understands that an appropriate redistribution policy would play a key role in mitigating this problem by improving and strengthening the education sector, the health sector, and access to public services. Various strategies are being implemented in the education sector, including education for all and all for education, to ensure free and quality access to education, and the Priority Action Plan to channel funds directly to the proper budget entities. In the health sector, the government has created the Health Sector Strategic Plan to achieve priorities in regard to health services delivery, behavioral change, quality improvements, human resource development, health financing, and institutional development.

The second kind of inequality has resulted from asymmetric information. Those who understand the potential of the new opportunities may advance quickly, while those who are unable to access the relevant information remain more vulnerable. Integration definitely involves a lot of business opportunities. People who have access to information—for example, about promising areas for new investment or potential areas for investment—or people who are able to determine the positive impacts of integration on areas of investment will be able to make huge profits in land speculation, business deals, and so on. Thus, in Siem Reap Province, those people who have understood the potential of this area to become a new tourist destination in Asia may make a lot of money through land speculation. Meanwhile, those who have not been able to understand this potential have lost significantly by selling their land to speculators at bargain prices and moving to more remote areas or becoming landless.

Cambodia is experiencing rising landlessness, and this problem has contributed to inequality significantly. Economic integration is one of the major causes of landlessness in Cambodia. As the price of land has risen because of the increase in foreign investments and the growing demand for land for hotel and factory construction, farmers have sold their lands cheaply. Moreover, because they lack knowledge about how to manage this sudden financial gain, the money has vanished quickly, and many farmers have become landless and poor. The proportion of landless rural households increased from 13 percent in 1997 to 16 percent in 1999 and 20 percent in 2004. The rise in landlessness has been relatively rapid given that land distribution was more or less equal when land was formally allocated to households in 1989. The problem has been exacerbated by the related problem of unclear property rights (as many as 80 percent of rural households that owned land were without titles to the land in 2004) and the ambiguous legal status of land ownership. The rising value of land in many parts of the country has complicated the issue. The result is an emerging phenomenon of increasing landlessness juxtaposed with the existence of uncultivated land. Realizing that this is not an easy problem to solve, the government has set up the Ministry of Land Management, Urbanization, and Construction for the sole purpose of managing land, clarifying land titling, and reviewing land concessions.

Finally, it is widely known that economic integration is accompanied by corruption. No country has been spared this unfortunate activity. Integration exposes countries to corruption, which contributes to a deterioration in the business environment. Since Cambodia began integrating with the world economy, we have experienced this phenomenon. Corruption definitely slows the integration process because investors are afraid to pour money into a corrupt environment, which, in turn, leads to slower growth in trade and other forms of integration. In the Cambodian case, corruption has not had a strong impact on integration into regional and global communities. One of the reasons for this is the fact that the government has been quite aware of the problem. The integration of Cambodia into regional and world communities means that the country must make commitments to reform so as to improve governance, the rule of law, and the establishment of an appropriate regulatory environment. To achieve this, the government has set up numerous mechanisms to tackle corruption, such as the Rectangular Strategy, which aims at good governance, and various reforms, including public financial management reform, judicial reform, and civil administration reform, along with the relevant joint working groups. Moreover, the government has also set up the Government–Private Sector Forum, in which the private sector may meet with the government to express complaints and grievances that the government then seeks to address.

Conclusion: the management of economic integration

Economic integration has been increasing, and the process is irreversible. It is difficult to conclude a priori that integration is either good or bad for Cambodia. Much will depend on how adroitly the process is managed. In any case, economic integration will definitely have both positive and negative impacts. The positive impacts will have to be maximized, and the negative impacts will have to be well managed if Cambodia is to benefit unequivocally from integration.

The government needs to maintain macroeconomic stability so as to create the proper conditions for investment and savings, to push for outward-oriented policies to promote efficiency through increased trade and investment, to promote structural reform to encourage domestic competition, and to create strong institutions to foster good governance.

Even though structural adjustment in many countries in East Asia has meant a decreasing share of agriculture in GDP, agriculture is still an important sector, providing employment and livelihoods for millions of people in rural areas. In many countries, even as the share of the agricultural sector in GDP has declined to around 30 percent, its share in total employment is still actually around 75–80 percent. Without agricultural development, it will be difficult to reduce rural poverty and release the resources needed for industrial development. In many areas, growth in the supply of basic staples is critical to ensure household food security and to sustain adequate real wages in agriculture. Moreover, the gains in agricultural productivity will reduce poverty by lowering food prices, raising farmer incomes, and creating employment opportunities.

The agricultural sector is often characterized as a classic case of market failure. More attention in the investments by the government in this sector is needed. At the same time, to promote the growth of agricultural productivity, the government must focus on the development of adequate rural infrastructure and communication networks and take steps to minimize transaction costs. Monetary policy must be geared to improving the access of farmers to formal institutional credit, particularly short-term seasonal credit. Land reform must ensure tenure and property rights. Simultaneously, efforts must be made to diversify to high-value cash crops and the provision of broader employment opportunities for the rural poor. Access to skills,

information, and technology, such as access to current price information on agricultural products, to machinery, and to fertilizers should also be improved, particularly in lagging regions where market failures are likely to become more pronounced.

Though there has been some progress, much more remains to be done to improve transparency and accountability in the formulation of public policy, in public-private relationships, and in the rules and procedures governing the allocation of public resources. To a significant extent, the issues all revolve around the requirement for a better understanding of the governance needs of the poor. These needs appear to lie in the following areas: (1) better service delivery, particularly in health care and education; (2) a reduction of leakage in targeted antipoverty programs; (3) access to justice for all; (4) regulatory support for the informal and unorganized sectors of the economy, where a majority of the poor pursue their livelihoods; and (5) a reduction in the threats of erosion in the incomes of the poor because of various forms of income insecurity and the improper application of administrative authority. In this sense, improving governance also means improving service delivery to poor and marginalized groups. The quantity and quality of the services delivered by governments in the areas of health care, education, clean water, sanitation, and so on are still lagging in many countries. One in three people in Asia's urban centers lack access to basic services, water, sanitation, and secure housing. The plight of those left behind has to be accorded top priority in the reform of governance.

More transparency and accountability in government expenditures and more well targeted spending on the poor will definitely contribute to better service delivery. The government needs to ensure that the money it spends reaches the poor. A key requirement is the tight monitoring of the outputs and outcomes of public expenditure programs.

Decentralization is also important for improving the effectiveness of service delivery. There has been notable progress in decentralization and in achieving innovations through public-private partnerships in service delivery in several countries. The decentralization of public administration and the empowerment of local institutions have recently been promoted in many Asian countries, including Cambodia, China, India, Indonesia, and Pakistan. Decentralization has widened the scope for citizens at the grassroots to influence decision making in resource allocation and to become responsible for the outcomes of their decisions.

Moreover, there is a need to provide social protection to the poor because most of the poor are vulnerable to adverse weather, economic recession, natural disasters, and ill health. Without social protection, some marginal families may easily fall into the poverty trap. Therefore, to protect these people, governments need to create sound risk-pooling mechanisms, social insurance schemes, social security systems, and pension systems. This is easier said than done and has posed challenges even in advanced economies. Although the task is daunting for the developing world, it may be ignored only at the risk of perpetuating poverty. We have to start rethinking the priorities in the allocation of public expenditures.

Overall, economic integration has done more good than harm. However, many of the concerns of those who oppose economic integration are also legitimate, and these should not be ignored. Greater efforts need to be made by national governments and by international institutions to address these concerns and assist the losers in the integration process without undermining the process itself. The winners must also contribute adequately to compensating the losers. However, there is no need to reverse direction or return to autarky. Since most of the costs of globalization are costs of adjustment, analogous costs would arise if we moved in the opposite direction.

Indeed, given how far the world has already come in the establishment of efficient global

markets, continued economic integration may well be less painful for all stakeholders than a return to the inward-looking policies of the past. The best way to deal with the challenges being raised by the international integration of markets is to be open and honest in recognizing the risks involved and address these risks in a transparent and humane way.

Notes

[1] For additional details, see Chaturvedi et al. (2006).
[2] Including Japan, the rise was from 34 to 51 percent.

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