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Impacts of the global economic crisis on foreign trade in lower-income economies in the Greater Mekong Sub-region and policy responses: The case of Vietnam and its implications for Lao PDR and Cambodia

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Impacts of the global economic crisis on foreign trade in lower-income economies in the Greater Mekong Sub-region and policy responses: the case of Vietnam and its implications for Lao PDR and Cambodia

by

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Executive Summary

The outbreak of the global financial crisis, the fluctuation of commodity prices, and the economic slowdown of the major trading partners in 2008 and the early 2009 has brought about one of the most difficult challenges to lower-income economies in the Greater Mekong Subregion (GMS, i.e. Vietnam, Lao PDR and Cambodia) since the Asian financial crisis of 1997-1998. Foreign trade, including both export and import, severely declined, leading to serious contraction of economic growth.

This research seeks to better understand the impacts of the global economic crisis on Vietnam's foreign trade and policy responses, and from this, draw inferences for Lao PDR and Cambodia. To this aim, it asks the following questions:

- To what extent was the foreign trade of Vietnam affected by the global economic crisis?
- What were the policies by the Vietnamese government to arrest and reverse the decline in foreign trade?
- What lessons can the Vietnamese experience offer to Lao PDR and Cambodia?

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1. Introduction

The six economies of the Greater Mekong Sub-region (GMS) include Cambodia, Lao PDR, Myanmar, Viet Nam (CLMV), Thailand and China's Yunnan Province. In the recent years, GMS countries have achieved remarkable success in their economic development and integration at both the sub-regional and global level. In 2001, China acceded to the World Trade Organization (WTO), followed by Cambodia in 2004 and Vietnam in 2006. At the same time, a dense web of sub-regional cooperation has been created, including the establishment of development triangles, opening of economic corridors, implementation of cross-border trade facilitation measures, and the acceleration of the completion of the ASEAN Free Trade Area by CLMV on their way toward membership in the ASEAN Economic Community (AEC).

At the same time, trade has been expanding faster than ever in the GMS. During the 1994-2006 period, intra-GMS exports, excluding those to China, grew at an annual average rate of 19% (People's Daily Online, 31/3/2008). From 2002 to 2006, total trade turnover between Cambodia and Thailand increased from US$ 259.88 million to US$ 411.29 million (Chanboreth, 2009). Trade with neighboring economies is especially important for Lao PDR and Myanmar. Lao PDR, for example, being a land-locked country, depends heavily on intra-regional trade, with 45% of its exports going to and 72% of its imports coming from the GMS in 2008. U.S economic sanctions have made Thailand and China Myanmar's two largest trading partners. Myanmar's trade with China, for instance, has grown steadily since the late 1980s, constituting 24% of its total foreign trade in 2008 (Pichai, 2009). In 2008, before the impact of the global economic crisis was fully felt, trade turnover of Vietnam with China, Lao PDR and Cambodia grew at the rates of 37.6%, 35.6% and 27.3% respectively compared to 2007 (MOIT, 2009).

The outbreak of the global financial crisis, fluctuations in oil, food, and other commodity prices, and the economic slowdown of the major trading partners in 2008 and early 2009 has brought about one of the most difficult challenges to the GMS economies since the Asian financial crisis of 1997-1998. The most important impact channel, exports, was severely decreased, leading to a serious contraction of economic growth. Among the lower income economies of the GMS, in 2009, the export volume of Vietnam fell 9.7%, contributing to a further decline of the economic growth rate from 6.18% in 2008 to 5.32% in 2009 (General Statistics Office, Annual Report 2009). Cambodian total exports showed a sharp decline of 18% compared to 2008, and the growth rate fell to 2.1% from 6.6% in 2008 (The Mirror, 21/1/2010). The relatively closed economy of Lao PDR also experienced a fall in its growth rate from 7.2% in 2008 to 6.4% in 2009 because of heavy drop in the price of its major export items. (Vientiane Times, 25/1/2010)

The above governments took important steps on both fiscal and monetary policy in response to the impacts of the crisis: Stimulus packages were launched; central banks reduced interest rates; fiscal authorities adopted expansionary policies; taxes were cut; and targeted cash transfers were made. These varied from country to country depending on their fiscal capabilities, but at least a few of these measures were taken in every case. Moreover, it became a popular view during the period of external economic turbulence that the more open is the economy, the more severe the impact. The adverse effects of the global economic crisis on foreign trade and economic growth have ushered in calls for the export-oriented developing economies to rebalance their growth sources by

choosing their domestic market for their own production (Kawai, 2009; Kuroda, 2009; Nag, 2009). Although this idea is correct and indeed timely, it may unconsciously provide a rationale for an increase in protectionism and the return to past import-substitution trade policies in these countries in the aftermath of the crisis.

This research seeks to better understand the impacts of the global economic crisis on Vietnam's foreign trade and policy responses, and from this, draw conclusions for Lao PDR and Cambodia. To this aim, it asks the following questions:

- To what extent was foreign trade of Vietnam affected by the global economic crisis?
- What were the policies by the Vietnamese government to arrest and reverse the decline in foreign trade?
- What lessons can Vietnam offer to Lao PDR and Cambodia for mutual advantages?

The rest of this paper is organized into **5** sections. The following section provides an overview of the impacts of the global financial crisis upon the Vietnamese economy, and discusses some key literature on the impact of the crisis on Vietnamese foreign trade. Section 3 analyzes the impacts of the crisis upon Vietnam's foreign trade in more detail. Section 4 reviews several policy responses of the Vietnamese Government. Section 5 discusses some important policy implications for Vietnam, Lao PDR and Cambodia.

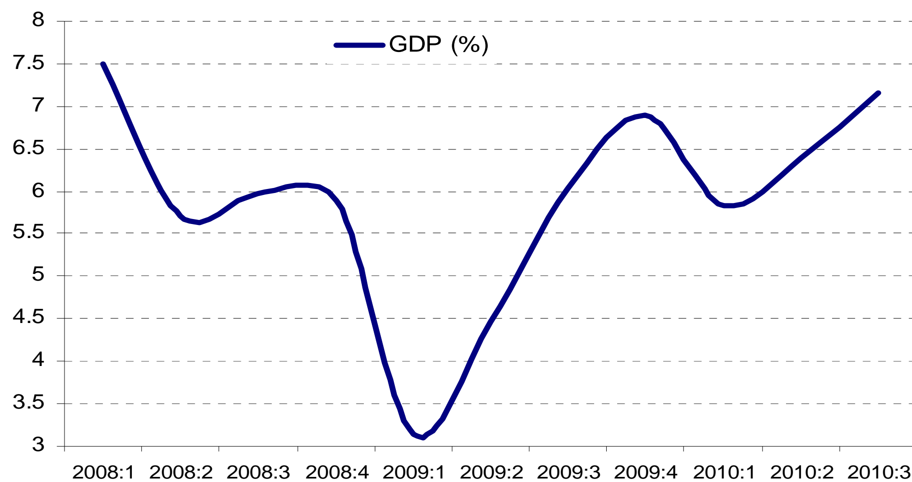
2. Overview of the Impact of the Global Economic Crisis on the Vietnamese Economy and Literature Review

Many economists initially insisted that the spillover effects of the US sub-prime mortgage crisis on the developing economies in Asia would be limited (Kawai, 2008). For the case of Vietnam, there was a reason to believe in this resilience because Vietnam's financial institutions were less exposed to the US sub-prime mortgage and structured financial products in other developed economies. Nonetheless, by the mid-2008, all optimism disappeared. The global crisis magnified the downturn cycle that Vietnamese economy had been experiencing since the end of 2007.

After its WTO accession, Vietnam experienced a surge in foreign investment, together with a boom in the stock exchange and the real estate sector. Rapid economic growth however became overheated, peaking in Q4 of 2007 at the cost of high inflation, which averaged 12.63% for the whole year. A contraction phase occurred in Q1 and Q2 of 2008. A soft landing of the economy did not happen in 2008, and its prospects were spoiled by the global economic recession.

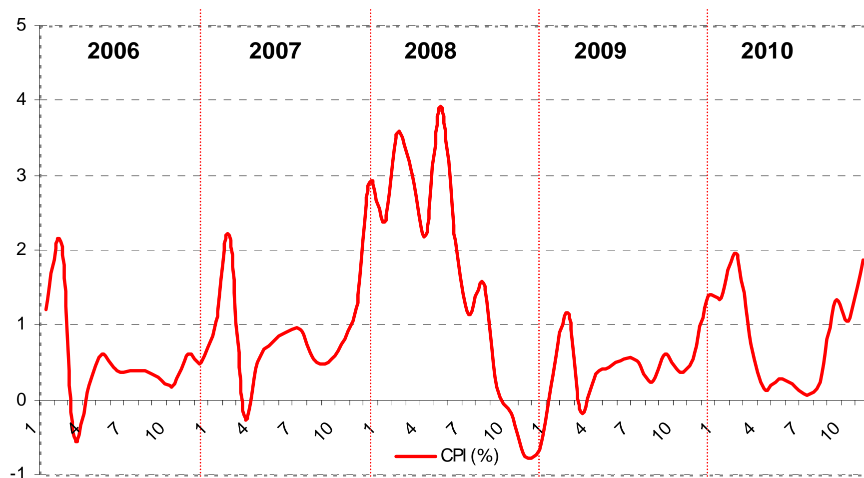
Figure 1 shows that the growth rate reached its trough in Q1 of 2009 at 3.14%, before picking up gradually to 4.46%, 6.04% and 6.9% in the consecutive quarters. The average economic growth rate in 2009 was 5.32% (GSO, 2009). Together with the world economy, the Vietnamese economy showed signs of recovery in 2010. The GDP growth rate moved up from 5.83% in Q1 and 6.4% in Q2 and 7.18% in Q3 of 2010 compared to the same period of 2009.

Figure 1: GDP Growth Rate by Quarter, 2008:1-2010:3



Source: General Statistics Office, 2010. Monthly Reports.

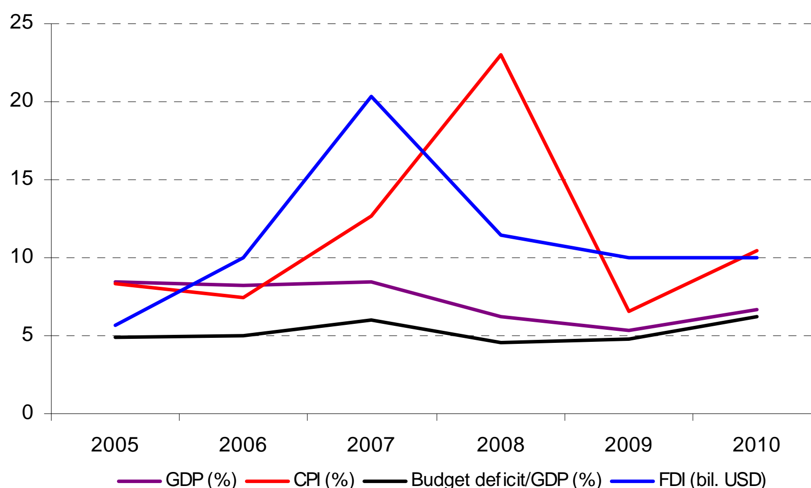
Figure 2: Monthly Inflation Rates



Source: General Statistics Office, 2010. Monthly Reports.

The inflation rate increased dramatically in the first half of 2008, reaching above 20% for the whole year. The increase in food commodity prices (20% in 2007 and 30% in 2008) contributed to the rise in inflation. The economic growth rate also fell from 8.6% in 2007 to 6.2% in 2008. An April 2009 study by the Ministry of Labor, Invalid and Social Affairs estimated that some 400,000-500,000 workers lost their jobs in 2009 as economic growth slowed further (laodong.com, 9/4/2009).

Figure 3: Some Key Indicators of the Vietnamese Economy, 2005 - 2010



Source: General Statistics Office, 2010.

Since as early as the outbreak of the global economic crisis, there have been a series of talks and numerous research papers tracing the progress of the crisis and discussing relevant policy responses. Most aspects of the crisis, including its impact on world trade, have become hot topics

on the academic agenda. The impacts of the crisis on Vietnam's foreign trade are examined to varying degrees in most of works which study the impacts of the crisis on the Vietnamese economy and policy responses, recognizing that trade is among the most important impact channels. In addition to the description above, the section only listed some important relevant works by both foreign and domestic researchers to our knowledge.

In a broader context, the paper "The Global Economic Crisis and Developing Countries: Impact and Response" by Duncan Green, Richard King, and May Miller-Dawkins (2010) discusses the impact of the global economic crisis on developing countries and their responses. It focuses on the Asia-Pacific, Sub-Saharan Africa, and Latin America and the Caribbean region. In Asia and the Pacific, Vietnam is listed among the countries at lower stages of development. The impact of the crisis was in line with that on other countries at the same rank of economic productivity, including in the informal economy and at the household level. In the formal economy, there were high levels of unemployment, especially in highly extensive export sectors such as textile and garment. In the informal economy, home-based workers were laid off prior to permanent employees. Less demand for internal migrant workers resulted in less work choice, and thus lower pay for them. To deal with escalating food prices and reduced incomes, families tried to cut down on food consumption. Some took loans or sold assets to cope. The rural economy is often seen as a sector resilient to falling income. However, as the crops shrank and food prices climbed, this form of resilience was not particularly effective.

Regarding the literature considered in this review four important points need to be highlighted:

First, the existing studies attribute the negative impact of the global economic crisis on the Vietnamese economy in part to its heavy reliance on exports as the source of growth (Chhibber et al, 2009; Bhaskaran and Ghosh, 2010; Pham, 2009; Le, 2009; Nguyen et al, 2010). The magnitude of the impact indicates the Vietnamese economy's level of dependence on global trade. In addition, there is a consensus that Vietnam's export growth declined because of the decline in demand from industrialized countries experiencing their own recessions, especially the G3 (USA, EU and Japan), which are the main markets for Vietnamese exporters (Le, 2009; Pham, 2009; Nguyen et al, 2010). This insight into the "external" dispersion of trading partners is accurate, but it is not the whole story concerning the recession in foreign trade. Another explanation can be found in the domestic economy.

Second, a number of authors pointed out that Vietnam had already undergone a year of considerable macroeconomic turbulence even before the crisis (Le, 2009; Nguyen et al, 2010). For example, in her paper "Vietnam's policy responses to the financial crisis," Le Thi Thuy Van (2009) pointed out that the Vietnamese economy had been in the midst of macroeconomic instability when it was hit by the global financial crisis, causing the economic environment to deteriorate further. Domestically, the economy had undergone a period of surging inflation and mounting twin deficits in both the fiscal and current accounts in recent years. The external shocks then worsened the structural weaknesses of the economy. As domestic consumption weakened and export orders decreased, industrial production stagnated and unemployment increased rapidly. The crisis thus posed a serious test of the government's capacity to manage the ailing economy in the global downturn.

Third, some studies attempt to look into at the trading structure of the domestic economy (Pham 2009, Nguyen et al, 2010). For example, in a recent paper, Nguyen Ngoc Anh, Nguyen Duc Nhat and Nguyen Thang (2010) point out that not only exports but also imports fell dramatically as the consequence of the crisis. The reason is that Vietnam's exports contain a high import component of intermediate goods; when exports declined, imports dropped concomitantly in an even greater amount. This is true even for sectors where Vietnam is seen as having great advantages in exports such as textiles and electronics. The coverage and insights of the majority of those studies however are still limited to the extent that they only aim to provide a preliminary analysis without applying a specific quantitative model. Further steps thus need to be taken, for example by looking at the powerful factors that affect export and import structures and their interrelationships, in order to provide policy recommendations for Vietnam in the integration process.

Fourth, in line with other responses by the developing economies in Asia, enhancing "resilience" has been said to be Vietnam's key priority in the aftermath of the economic crisis. For example, Manu Bhaskaran and Ritwick Ghosh (2010) contend that from 2000 to 2008, there was an increase in the resiliency of Vietnamese economy thanks to increased domestic demand and an improvement in the political and regulatory environment unleashed by the reforms. This positive development should be encouraged as part of a continuing policy response in the post-crisis period.

3. Impacts of the Global Financial Crisis on Vietnam's Foreign Trade

Overall, although the existing literature may be adequate to help the readers to understand the impact of the global crisis on the Vietnamese economy and the policy responses in general, much needs to be done with regard to studies of foreign trade which can serve as a theme which cuts across all aspects of the process of integration.

Foreign trade was the most prominent channel in transferring global shocks to Vietnamese economy. Figure 4 shows monthly growth rates of exports and imports. Both exports and imports began to decline in mid-2008, and they reached their respective bottoms in April 2009 and August 2009.

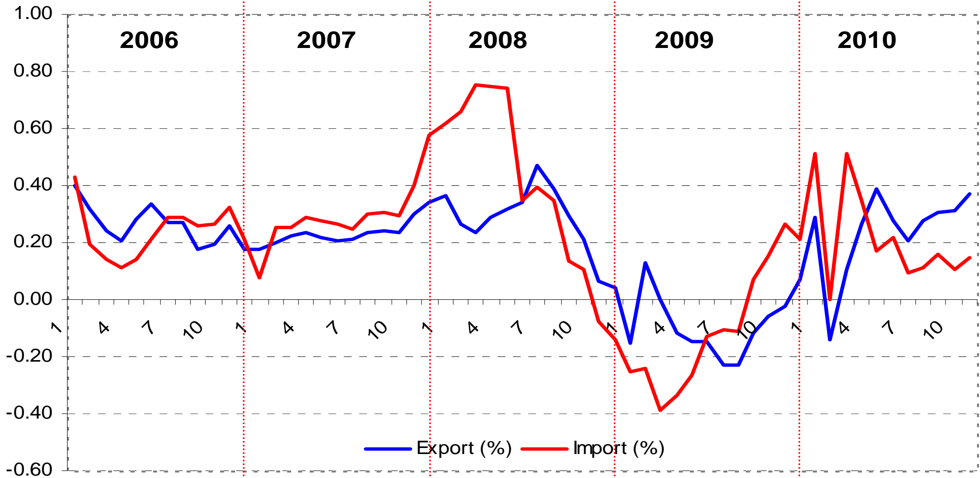
Imports depended heavily on the recovery of domestic demand. Demand was severely impacted by high inflation at the beginning of 2008. A decrease in foreign direct investment also contributed to a reduction in the demand for imports because foreign companies import the inputs for their production. The declining trend only began to reverse in the beginning of 2009 as the government implemented several measures to prevent the slowdown of the economy[1] and stimulate the demand for imports.

Vietnamese exports depend heavily on the recovery of the world economy, particularly recovery in major trading partners. The growth rate of exports was 0.47% in July 2008 compared to the same

[1] i.e. The Government subsidized 4 percentage points of interest on short-term business loans, invested on upgrading and constructing infrastructure, and so on.

month in 2007, before falling further in the following months[2] and even turning negative at the beginning of 2009. The relationship of the global financial crisis with the reduction in exports was thus obvious. Compared to imports, the recovery in exports came later because the recovery of the world economy also came later than that of domestic economy. The lag in the recovery on imports and exports is shown in Figure 4.

Figure 4. Growth rate of exports and imports, month-by-month



Source: General Statistics Office

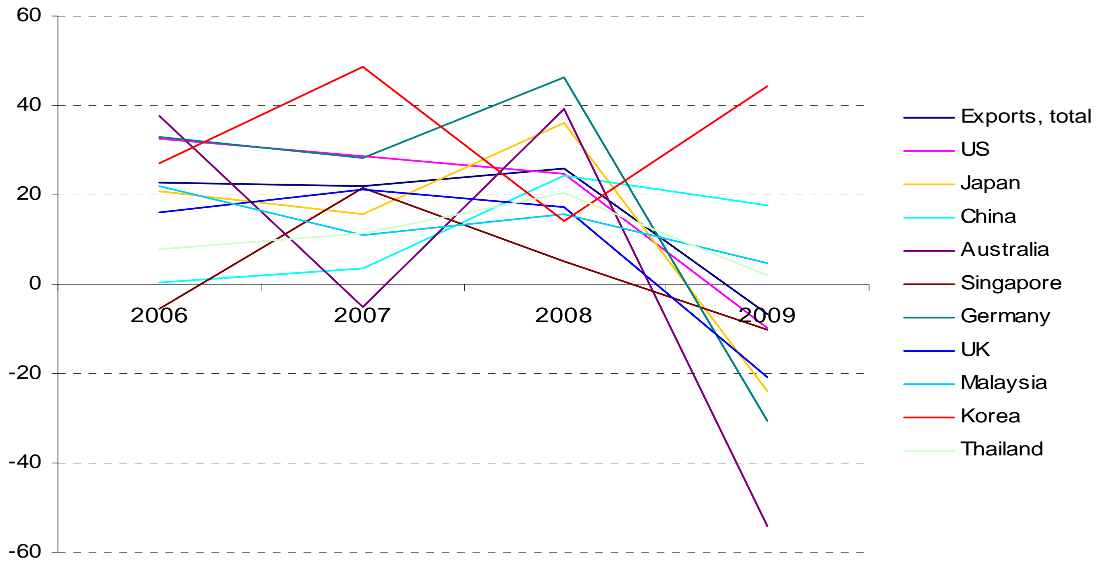
Impacts by Country

It is clear that exports to many major trading partners dropped. Exports to the Australian market were hit hardest. Next were Germany, Japan, the United Kingdom, and Singapore. These are the economies which were most negatively affected by the global financial crisis.

Exports to Korea increased, and exports to China declined slightly. The Chinese economy was not as negatively impacted as other major economies by the crisis, and it quickly recovered. However, it is surprising to see an increase in exports to Korea, because the Korean economy was quite adversely affected by the crisis.

[2] i.e. 0.39% in August, 0.29% in September, 0.21% in October, 0.07% in November, and 0.04% in December

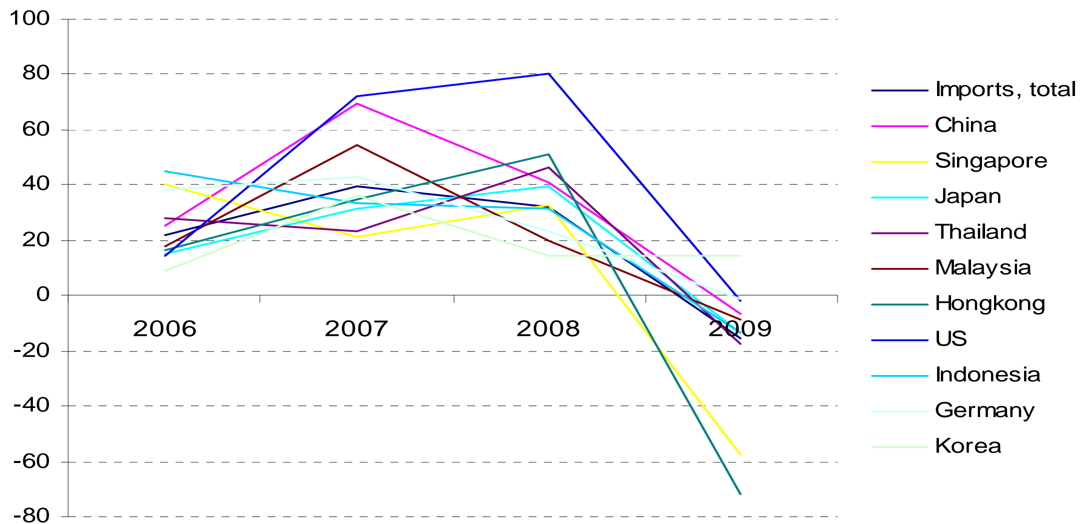
Figure 5. Growth rate of exports by country, %



Source: General Statistics Office, 2010.

We can clearly see from the chart that imports fell significantly in 2009, including imports from major trading partners. However, imports from the Korean economy increased slightly. This demonstrates that for the Korean economy, exports and imports are not perfectly elastic with respect to income and price.

Figure 6. Growth rates of imports by country, %

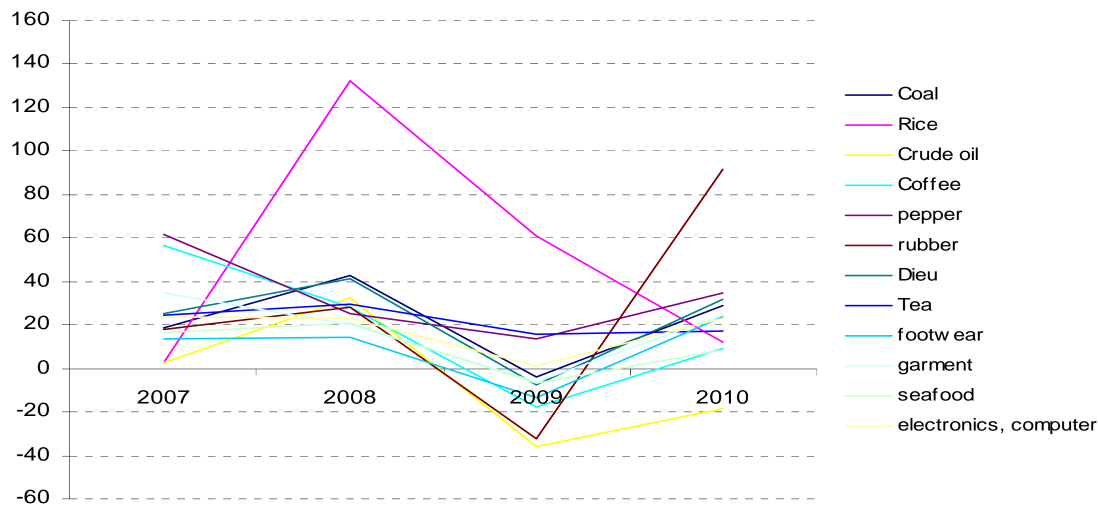


Source: General Statistics Office, 2010.

Impacts by Commodity

For several major export products such as garments, footwear and furniture, orders dropped quickly, while seafood producers were also under pressure. This reduction in orders caused great difficulties to exporters, putting many of them at risk of closing down. Exports of crude oil fell sharply, by almost a half in 2009, because of a fall in the global oil price. Coal exports fell by 20% in the first 7 months of 2009. According to the Vietnam Textile Association, Vietnam's garment exports, after hitting a record high in 2008, experienced a slowdown in the first half of 2009.[3] The fall in export volume of the foreign investment sector was greater than that of the domestic sector (15 % compared to 5 %). In contrast, imports in the foreign sector dropped by around 10% compared to a fall of 17% in the domestic sector (GSO, 2009). Although the decline may be less severe than in some other developing countries, its unexpected magnitude made 2009 the worst year for exports since the beginning of Vietnam's economic reforms (Vietnam Biz Updates Weekly, 2009).

Figure 7. Growth rates of exports by Commodity



Source: General Statistics Office.

Similar to exports, Vietnamese imports declined quickly for two reasons. First, there was an increase in the rate of inflation and a corresponding interest rate hike in 2008 (as part of a tightened monetary policy by Vietnamese Government to combat the high inflation rate) that adversely impacted both private and state-owned enterprises in the domestic economy. As a result, these enterprises cut down their production and reduced their imports. Second, because of a decline in demand due to the impact of the global financial crisis and economic slowdown, both domestic and foreign-owned enterprises had to reduce their production and imports.

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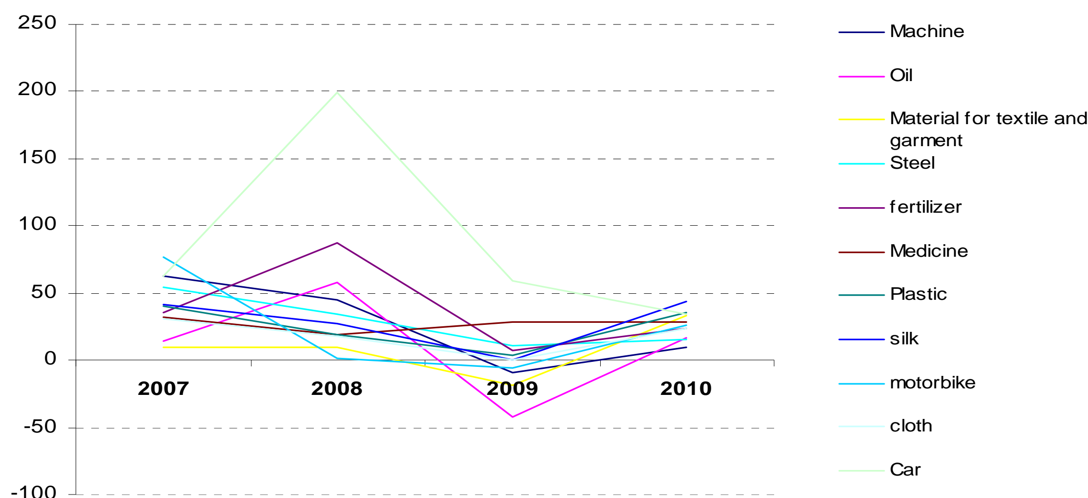
[3] In 2008, the U.S was the biggest importer of Vietnam's garment products (57% of market share), followed by the EU (18%), and Japan (9%).

It is not surprising that the fall in oil prices led to a decline in oil import values. This was also the case for imports of raw materials for textiles and garments because, as mentioned above, the exports of the textiles and garments also fell. Car imports also declined during this period of economic hardship and uncertainty.

Figure 8. Growth rates of imports for major commodities



Source: General Statistics Office.

Transmission Mechanisms

a) Slowdown in foreign economies

As their incomes dropped under the economic distress, consumers in many important trading partners of Vietnam such as the United States, Japan, and the EU were forced to cut down their expenditures on goods and services, including imported foreign commodities.

The fall in imported consumption goods from Vietnam, including those with large export volumes such as coffee and footwear, was not severe because their elasticity with respect to income is low. As a result, the recovery in these goods took place quite quickly.

However, there was a heavy drop in production goods and raw materials such as rubber and coal because of the curtailment of production activities of Vietnam's major trading partners.

The recovery in Vietnamese exports occurred in tandem with the economic recovery of Vietnam's major trading partners. Exports of rubber, which were hit hardest, recovered most rapidly, followed by other important commodities such as coffee and footwear. Exports of crude oil increased slightly because global demand had not fully recovered.

b) The slowdown of the domestic economy

The fall in imports was also caused by a fall of domestic demand for consumption and industrial goods.

High inflation at the beginning of 2008 forced the State Bank of Vietnam to tighten the money supply. Interest rates increased and credit terms were strict. Fiscal policy was also tightened accordingly, leading to a decrease in government expenditure. It then became more difficult for enterprises to borrow loans from banks and many enterprises had to reduce their production, discharge employees or reduce their salaries.

Starting in mid-2008, while the contractionary monetary policy was still in effect, the economy was hit by the adverse shocks of the global financial crisis. Investment, consumption, and government expenditure all dropped significantly in 2008 and 2009. The decline in household income led to a reduction of consumption of both domestic and imported commodities. For example, car imports decreased dramatically in 2009 to just US$59 million, below 2007 levels (US$62 million), compared to US$199 million in 2008. They continued to fall in 2010, albeit less severely. Imports of motorbikes decreased sharply in 2008 and 2009, but began to increase again in 2010.

Because the import of consumer goods comprises a small part of total import revenue (less than 10%), a reduction in total imports in 2009 came mainly from a decrease in the import of inputs for the production. Imports of gasoline and petroleum dropped most significantly, followed by imports of materials for textile and garment production.

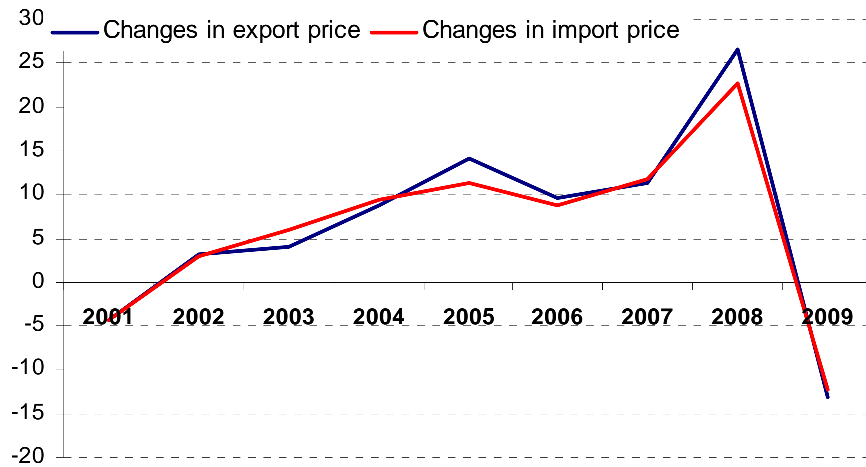
However, as mentioned above, the Vietnamese economic recovery was faster than that of its trading partners such as the U.S, Japan, and the EU, and the recovery in imports came earlier than that of exports.

c) Reduction in commodity prices

In 2008, the inflation rate of Vietnam was very high, reaching 23% compared with the previous year. The inflation rate of many countries in the world was also at a high level because of the increase in the price of oil and many other commodities. Consequently, the prices of several commodities (both exported and imported) were high in 2008.

However, the trend of increasing world commodity prices was suddenly reversed in 2009. Figure 9 shows that the prices of exports and imports were at highs in 2008 then plunged sharply. This fall in prices of exported and imported commodities resulted in a strong reduction in total export and import revenues, but did not have a significant impact on the trade deficit.

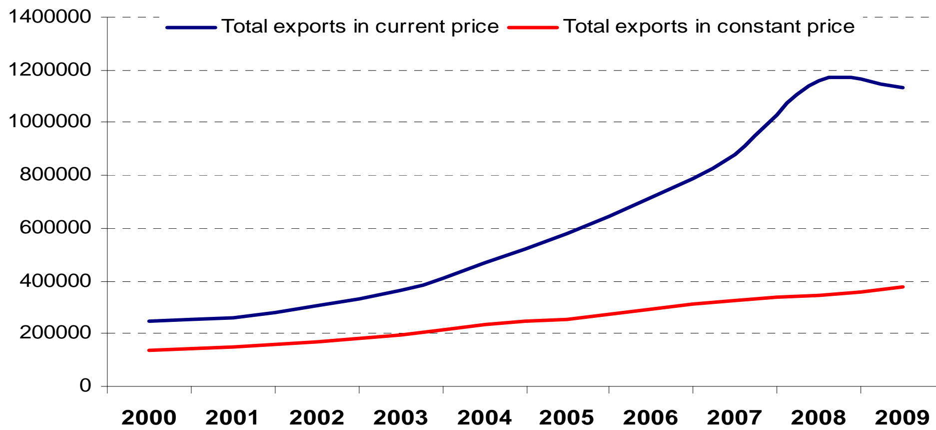
Figure 9. Changes in export price and import price, %.



Source: General Statistics Office, 2010; and author's calculations.

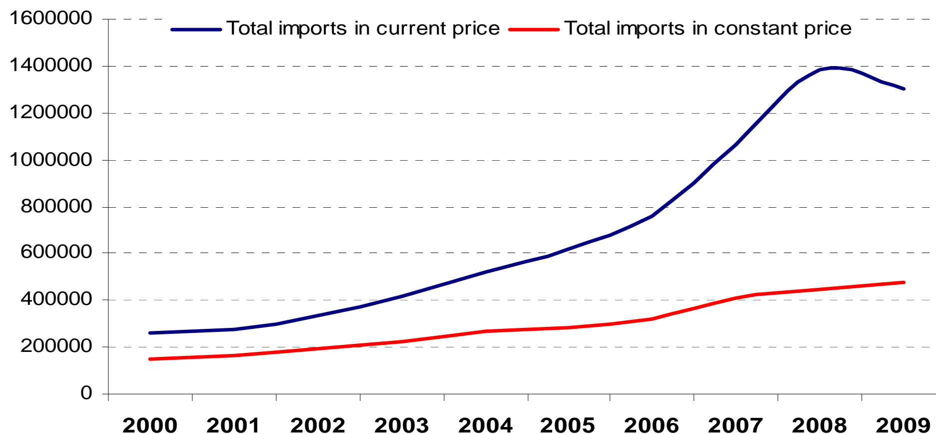
Figure 10 and Figure 11 indicate that although total export and import revenues (at constant 1994 prices) increased steadily over the years shown, even in 2009, a decrease in the prices of export and import commodities in 2009 resulted in a reduction in total export and import revenues at current prices. In 2008, while world prices decreased, Vietnamese exports still increased.

Figure 10. Total export revenue at current prices and at constant 1994 prices over the period 2000-2009, VND billion.



Source: General Statistics Office.

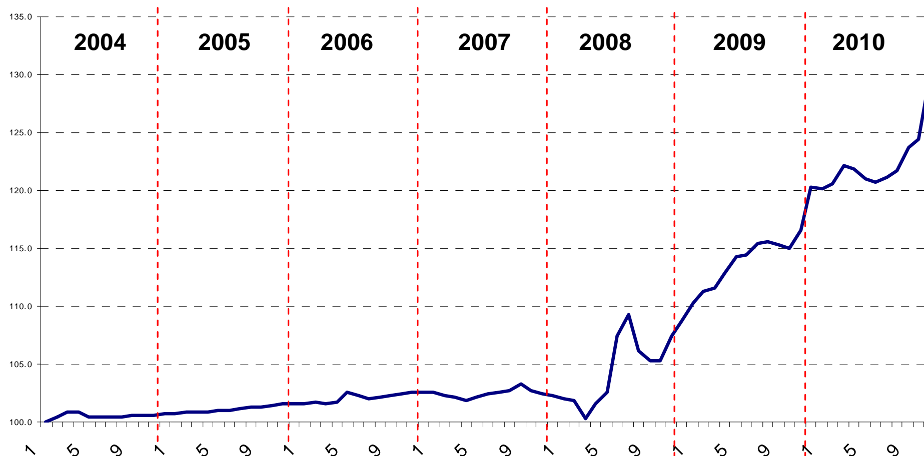
Figure 11. Total import revenue at current prices and at constant 1994 price over the period 2000-2009, VND billion.



Source: General Statistics Office.

Since 2008, the nominal exchange rate has increased. Although this policy was able to stimulate exports and discourage imports (see Figure 12), it also demonstrates the inherent macro-instability of the economy with regard to exchange rates and confidence in the VND.

Figure 12. Monthly Nominal Exchange Rate, 2004-2010



Source: General Statistics Office. Nominal exchange rate indexed at 100 in January 2004.

d) Protectionism

At the outbreak of the global financial crisis and the subsequent recession, many of Vietnam's trading partners deployed protectionist measures, and these adversely affected exports in a number of important products. In 2009, the number of antidumping, anti-subsidy and safeguard lawsuits against Vietnam reached a record high of 42 cases.

Vietnamese exporters are currently very vulnerable to such lawsuits because some major trading partners still refuse to recognize Vietnam as a market economy. Following the U.S shrimp case, in December 2009, the European Community also decided to extend its anti-dumping tariff on leather-capped shoes imported from Vietnam for 15 months. Unfortunately, the commodities with largest export revenues such as textiles, leather products, milled paper, and plastic products are also the most likely to be faced with lawsuits.

4. Policy Responses

During this difficult time, the VND/USD exchange rate increased from 16,600:1 in Q3 of 2008 to 18,479:1 in Q4 of 2009 (GSO, 2009), with the VND losing almost 11% of its value against the US dollar. However, these official figures were below those in the free market, where the rate had passed the 19,000 threshold. The further decline in the exchange rate exaggerated the negative impacts of global shocks on the Vietnamese economy and disturbed trading behavior by triggering a massive wave of speculation in the US dollar and an artificial shortage of this currency for importers.

The global economic crisis contributed to the expansion of Vietnam's chronic trade deficit, the growth rate of which has remained around 15% per year since 2000 (MUTRAP III, 2009: 16). In 2008, the trade deficit reached a record high of US$ 18 billion (ADB, 2009), or almost 32.1% of GDP. The trade deficit averaged US$ 2.2 billion per month in the first 5 months of 2008. In 2009, the trade deficit was reduced to US$ 12.2 billion, which was still at a level of 20.8% of GDP (GSO, 2009).

Monetary policy, led by the manipulation of interest rates and foreign exchange rates, was the first line of defense against the impacts of the crisis for the economy, including the trading sector.

Interest rate policies:

With the global economic downturn and the precipitous drop in oil and other commodity prices, inflation pressure, which was still high in late July of 2008, gradually dissipated. This gave the SBV greater room to reduce rates to support sagging production activities, including those by importers and exporters. Policies were quickly adjusted in tandem with the rapid changes in the market. The following is the brief chronology of some relevant events:

- February – June 2008: The base interest rate was brought up from 8.25% to 14% to cope with the inflation, pushing the deposit rates and lending rates of commercial banks up to their peaks at 17-18% and 20-21% respectively in August-early September.
- September 2008: With inflation easing, the SBV increased the required reserve rate for commercial banks from 3.6% to 5% to help reduce lending rates.
- 1 February 2009: The base interest rate was cut to 7%.
- 1 March 2009: The SBV reduced the required reserve ratio for VND deposits (demand deposits and savings deposits) from 5% to 3%. The ratio for deposits longer than 12 months was 1%.
- 1 December 2009: The base interest rate increased from 7% to 8% (the recapitalization interest rate from 7% to 8%, and the discount rate from 5% to 6%). The aim was to control the quality of credit by commercial banks and coordinate interest rates with exchange rate policy.

Exchange rate policy:

Although the VND had long been pegged to the US dollar, starting in mid-2008, the SBV took steps toward a more flexible exchange rate mechanism to reduce devaluation pressure on the VND:

- 27 June 2008: The exchange rate trading band increased to 2% from 1%.
- 7 November 2008: The band increased to 3 % from 2 %.
- 24 March 2009: The band was extended to 5% from 3%.
- 26 November 2009: The interbank exchange rate band increased by 5.44% (at the same time, the US/VND exchange band was narrowed to 3% from 5%), thus increasing the exchange rate ceiling by 3.44% (at 18,500 VND per USD).

The fluctuation of exchange rates in recent months and the imbalance between foreign currency supply and demand has led to massive wave of speculation and shown that the exchange rate is still the Achilles' heel of the Vietnamese economy and a big risk to traders.

Fiscal measures were the next line of defense. In January 2009, the Vietnamese government announced the first stimulus package, in the amount of US$ 1 billion. The package proposed a 4% interest rate subsidy for businesses and individuals over a period of 8 months, ending on December 31st, 2009. In May 2009, the Ministry of Planning and Investment (MPI) announced the second stimulus package of VND 143,000 billion (US$ 8 billion or 8.3% of GDP) to further spur growth amid the deepening global recession. The second package has eight components:

- Supporting low-interest credit loans (about VND 17,000 billion);
- Disbursement of basic construction investment capital to be provided in advance (approximately VND 3,400 billion),
- Spending on the state budget account to complete certain urgent projects (about VND 37,200 billion);
- Transferring plan investment capital from 2008 to 2009 (about VND 30,200 billion),
- Issuing more Government bonds (around VND 20,000 billion);
- Tax reduction (approximately VND 28,000 billion);
- Increasing outstanding debt in the form of credit guarantees for enterprises (about VND 17,000 billion); and
- Other expenses to stimulate demand aiming at stopping the economic recession and ensuring social security (VND 7,200 billion) (Vn.economy.vn, 13/5/2009).
- In general, the stimulus policies implemented since 2008 have helped boost exports. Below are some examples of measures targeted at enterprises:
- Since 1 January 2009: reduced corporate tax rate (from 28% to 25%).
- Since 23 January 2009: VND-dominated loans at a subsidized interest rate of 4% interest, disbursed during 2009 with a maximum duration of 8 months.
- In Q4 of 2008 and all of 2009: reduction of corporate tax by 30% for small and medium enterprises.
- Reducing of VAT by half for 19 groups of products and services in 2009, including materials and machines for production and export.
- From 15 February 2009: reduction of export duties for several commodities (such as fossil coal) to 10% from the existing level of 20%.
- From 29 March 2009: extending the payment period for corporate taxes on mechanical products, construction materials (such as brick, tile, lime, and paint), installation services, tourism, food businesses, and fertilizer for a period of 9 months.
- Guaranteeing working capital loans to enterprises (Decision 14/2009/QĐ-TTg)
- From 1 April 2009 to 31 December 2011: a subsidized 4% annual interest rate for enterprises, applied to medium and long term loans and disbursed from 1/4/ 2009 - 31/12/2009 for a maximum period of 24 months.

Thus, the stimulus package covers a wide range of incentives provided to export industries. It not only seeks to assist exporters in general (such as by reduction of corporate taxes and interest rate subsidies) but also to promote the export of specific commodities and services (such as the reduction of export duties). In addition, the depreciation of the VND has also played an important role in boosting exports.

Nonetheless, those policies have not been very helpful in reducing the mounting trade deficit. Under the backdrop of the global crisis, although both export revenue (US$ 56.6 billion) and import revenue (US$ 68.8 billion) dropped in 2009 (9.7% and 10.8% respectively compared to 2008 figures), the trade deficit still equaled 21.5% of total export revenue (GSO, 2009). This is due the fact that a large proportion of the inputs for export goods are imported. Vietnamese export products have very low added value, even those seen as competitive in the global market such as garments, textiles, and tea.

Moreover, the depreciation of the VND has been a major concern for Vietnam's export competitors in the region, including neighboring countries such as Thailand, Cambodia and Lao PDR, since they export many of the same commodities. These include garments, textiles, tea, rice and other agricultural and aquacultural products.

Additionally, the existing policy mostly focuses on trade in manufactured products and services but little on agricultural trade. For instance, there are subsidies and tariff reductions on imported inputs, but no corresponding support for agriculture. This is understandable given that a number of Vietnamese agricultural and aquacultural products are subject to antidumping lawsuits from trading partners. Fortunately, as a WTO member, Vietnam has a major advantage in that it may take those cases to the WTO dispute settlement body and in so doing reduce the arbitrary imposition of trade barriers by foreign partners. The dispute over shrimp exports to the U.S. is such a case.

5. Discussion of Policy Implications

The policy responses of Vietnam have important implications for Cambodia and Lao PDR. Similar to Vietnam, Cambodia and Lao PDR have adopted monetary and fiscal policies to blunt the impact of the global crisis on their foreign trade.

The initial reaction by the Cambodian government was to increase the reserve requirements of commercial banks from 8% to 16%, but it was later reduced to 12% once inflation conditions permitted some room for monetary easing. To prevent bad investments, the government also limited banks' exposure to high-risk sectors, specifically real estate, by introducing a 15% cap on real estate lending (Hoang, 2009: 7).

The vulnerability of lower-income economies in the GMS such as Lao PDR, Cambodia and Vietnam to external shocks highlights the importance of exchange rate management choices in contributing to macroeconomic and financial stability. This requires prudent capital account openness and consideration of the sequence of capital market liberalization in order to ensure

relatively stable exchange rates. Cambodia, Lao PDR, and Vietnam are currently more or less under managed floating foreign exchange regimes.

Stimulus packages have also been adopted and have proved able to produce quick results in the Lao and Cambodian economies. During its 6th ordinary session in December 2008, the 6th Legislature of the Lao National Assembly approved additional funding for the government, increasing its budget for 2008-2009 from 10,026 billion Kip to 10,648 billion Kip. While the additional money was originally for the purpose of helping the country recover from damage caused by severe flooding in September 2008, it also had important demand-side leverage effects. In addition, the Asian Development Bank also pledged to increase its financial assistance to Lao PDR over the following two years to help the country mitigate the impacts of the global financial crisis and enable its economy to recover. In 2008, the ADB provided Lao PDR a total of US$ 53 million in assistance which was mainly used to fund Laos' poverty reduction projects in rural areas. For 2009, the Bank allocated US$ 89 million to fund five important projects: improving the quality of higher education, developing public health services, improving the production efficiency of small and medium businesses, developing and improving transportation and communication links between northern areas of Lao PDR and neighboring GMS countries, and providing technical assistance to the Lao administration (VOA News, 8/1/2009). In addition, stimulus effects also came from investment on projects related to the South-East Asia Games that Lao PDR hosted in 2009.

In December 2008, Cambodian lawmakers passed a US$ 1.8 billion budget for 2009, increasing spending by a third compared to the US$ 1.37 billion 2008 budget. The budget was passed after donor countries pledged US$ 950 million in aid, almost 40% more than they offered in 2008. However, the government was under pressure to have a stimulus package following what was done worldwide and in neighboring countries. In January 2009, opposition leader Sam Rainsy proposed a US$ 500 million stimulus package in order to help the Cambodian economy overcome the economic recession. The money would go to stabilizing crop prices and the construction of irrigation and road networks. Although the government criticized the proposed budget as excessive given the limited budget, it said that it would extend tax breaks for clothing manufacturers and invest in power plants as a cash shortage restricted its ability to provide economic stimulus. According to Finance Minister Keath Chhon, the government already subsidized electricity by US$300 million in 2008 and the fiber industry by US$450 million, while total intervention accounted for 4.9% of Cambodia's GDP.

Responses to the global crisis in foreign trade by lower-income economies in the GMS such as Lao PDR, Cambodia and Vietnam share important policy dimensions, especially in terms of sub-regional cooperation.

First, like other developing Asian economies, the economies of Vietnam, Lao PDR and Cambodia rely too much on exports and foreign investment as the sources of growth. There was a remarkably synchronized contraction in trade and investment across these countries, which was generally consistent with their position in global and regional production networks. This kind of vulnerability was even greater for such economies as Vietnam and Cambodia, which have recently become WTO members. Although trade with neighboring economies is very important (especially

for countries with geographical disadvantages such as Lao PDR), it has been either inadequately promoted or improperly exploited by the private sector, perhaps due to the prevalence of smuggling.

Second, there has been congruence and synergy in policy responses as these countries adopted monetary and fiscal measures. These policies were quite successful, but they were still limited by their largely national, independent, and uncoordinated characters, given that the GMS economies are increasingly interdependent with each other in trade, investment, and finance. Indeed, there has been a "stimulus pressure" upon smaller countries with limited budgets such as Lao PDR and Cambodia who can not afford to compete with Thailand and Vietnam in terms of stimulus package size. However, fiscal policy stimulus can have a positive spillover effect on the neighboring countries through trade. Although this is to the benefit of smaller economies, these smaller economies should not see this as an incentive to "free ride" since this would lead to a smaller than desirable fiscal stimulus.

Third, although the risk of defection is always high in such moments of difficulty, lower-income GMS economies have not pursued beggar-thy-neighbor policies. They have not taken aggressive moves to encourage exports such as sharp currency devaluations, the provision of favorable tax treatment for exports, or raising tariffs to protect domestic industries by discouraging imports.

Finally, in their responses to the global recession, Lao PDR, Cambodia and Vietnam should look at ways to rebalance their growth. That means they must become a market for their own domestic production. The ultimate objective of growth rebalancing is not to restore the current account balance (Kawai, 2009). Export-led growth of such market-oriented economies such as those in the GMS may result in surpluses or deficits, but this trend must be justified by an appropriate foreign trade structure and the advancement of those economies' positions in the global value chain. Also, rebalancing should proceed by removing impediments to domestic consumption by increasing the purchasing power of consumers and their opportunities to access cheaper domestic commodities.

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Appendix 1:

Direction of Trade (million US Dollars; calendar year) and annual rates of change

	2005	2006	2007	2008	2009
Exports, total	**32 447.1**	**39 826**	**48 561**	**61 180**	**57 096.3**
		22.74	21.93	25.99	-6.67
1. United States	5924.0	7845	10089	12594	11355.8
		32.43	28.60	24.83	-9.83
2. Japan	4340.3	5240	6070	8264	6291.8
		20.73	15.84	36.14	-23.86
3. China, People's Republic of	3228.1	3243	3357	4174	4909.0
		0.46	3.52	24.34	17.61
4. Australia	2722.8	3745	3557	4957	2276.7
		37.54	-5.02	39.36	-54.07
5. Singapore	1917.0	1812	2202	2314	2076.3
		-5.48	21.52	5.09	-10.27
6. Germany	1085.5	1445	1855	2715	1885.4
		33.12	28.37	46.36	-30.56
7. United Kingdom	1015.8	1180	1431	1679	1329.2
		16.16	21.27	17.33	-20.83
8. Malaysia	1028.3	1254	1390	1606	1681.6
		21.95	10.85	15.54	4.71
9. Korea, Republic of	663.6	843	1253	1430	2064.5
		27.03	48.64	14.13	44.37
10. Thailand	863.0	930	1034	1244	1266.1
		7.76	11.18	20.31	1.78

Source: GSO, 2009.

Appendix 2:

Direction of Trade (million US Dollars; calendar year) and annual rates of change

	2005	2006	2007	2008	2009
Imports, total	**36 761.1**	**44 891**	**62 682**	**82 954**	**69 948.8**
		22.12	39.63	32.34	-15.68
1. China, People's Republic of	5899.7	7391	12502	17593	16441.0
		25.28	69.15	40.72	-6.55
2. Singapore	4482.3	6274	7609	10085	4248.4
		39.97	21.28	32.54	-57.87
3. Japan	4074.1	4702	6178	8615	7468.1
		15.41	31.39	39.45	-13.31
4. Korea, Republic of	3594.1	3908	5334	6090	6976.4
		8.73	36.49	14.17	14.56
5. Thailand	2374.1	3034	3737	5459	4514.1
		27.80	23.17	46.08	-17.31
6. Malaysia	1256.5	1482	2290	2747	2504.7
		17.95	54.52	19.96	-8.82
7. Hong Kong, China	1235.0	1441	1941	2927	825.6
		16.68	34.70	50.80	-71.79
8. United States	862.9	987	1700	3069	3009.4
		14.38	72.24	80.53	-1.94
9. Indonesia	700.0	1013	1354	1780	1546.1
		44.71	33.66	31.46	-13.14
10. Germany	661.9	915	1309	1612	1587.3
		38.24	43.06	23.15	-1.53

Source: GSO, 2009.

Appendix 3:

Annual rates of change of exports and imports by commodities (%)

	2007	2008	2009	2010
Export (%)				
Coal	18.36	43.04	-3.96	28.51
Rice	2.69	132.43	61.02	12.34
Crude oil	2.29	32.75	-36.01	-18.68
Coffee	56.77	28.12	-17.81	9.07
Pepper	61.84	25.13	13.94	34.87
Rubber	17.90	27.86	-32.30	91.36
Cashew nut	25.22	41.44	-7.34	31.48
Tea	24.72	29.60	15.52	17.49
Footware	13.77	14.26	-13.70	23.45
Textile	34.97	20.05	-6.15	24.43
Aquaculture product	16.27	20.71	-6.52	8.69
Electronic, computer	23.81	23.24	1.54	23.09
Import (%)				
Mechanic instruments	62.12	45.34	-8.90	10.07
Gas and petrol	14.46	57.93	-42.01	16.27
Inputs for textile and leather	9.24	9.66	-19.27	33.38
Steel	54.38	34.71	10.75	15.90
Fertilizer	35.92	86.79	7.08	23.33
Medicine	31.62	19.18	28.14	28.87
Plastic	39.80	18.76	3.50	35.15
Textile fiber	41.79	27.77	0.11	44.05
Motorbike	76.66	1.46	-5.70	25.60
Cloth	31.19	18.24	0.25	24.17
Cars	62.10	199.64	59.46	34.89