Global Financial crisis and responses from the GMS countries

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Abstract. The recent period has witnessed the remarkable achievements of the Greater Mekong Sub-region (GMS) countries in their economic development and integration which occurred not only at the sub-regional but also at the global level. Nonetheless, the outbreak of the global financial crisis, the fluctuation of oil, food, and other commodity prices, and the slowdown of the industrialized economies in 2008 and the early 2009 has brought about one of the most difficult challenges to the GMS economies since the Asian financial crisis of 1997 - 1998. This article will discuss the impacts of the global financial crisis on the GMS economies and their policy responses. Although the economic prospective of the GMS depends heavily on the recovery of the global economy, proper policy measures implemented by the governments in the sub-region will contribute a large part to stabilize the market and restore growth.

1. Introduction

The recent period has witnessed remarkable achievements of the Greater Mekong Sub-region (GMS) countries in their economic development and integration which occurred not only at the sub-regional but also at the global level. Nonetheless, the outbreak of the global financial crisis, the fluctuation of oil, food, and other commodity prices, and the slowdown of the industrialized economies in 2008 and the early 2009 has brought about one of the most difficult challenges to the GMS economies since the Asian financial crisis of 1997 - 1998.

This article will discuss the impacts of the global financial crisis on the GMS economies and their policy responses. Although the economic prospective of the GMS depends heavily on the recovery of the global economy, proper policy measures implemented by the governments in the sub-region will contribute a large part to stabilize the market and restore growth.

2. The impacts of the global financial crisis on the GMS economies

Many economists initially insisted that the spillover effects of the US sub-prime mortgage crisis on Asian in general and the GMS economies in particular would have been relatively limited (Kawai, 2008). There were a few reasons to believe in the resilience of the GMS economies: First, the sub-region’s financial institutions have been less exposed to the US sub-prime mortgage and structured financial products in other developed economies. Second, in most GMS countries, demand, both external and domestic, was still
sustained. Exports had not fallen down significantly and, in addition, domestic demand was making an increasing contribution to growth. *Third*, in such countries as Thailand, enhanced macroeconomic management and financial sector reforms implemented since the Asian crisis have helped mitigate the impact of external shocks.

However, all optimistic predictions were revised at the dramatic fallout the global financial crisis together with soaring prices for oil, food and other commodities. A sketchy picture of the GMS economies during the turbulent year of 2008 and early 2009 showed that the impact of the global shocks was significant for all, regardless of their openness and integration levels, from a highly open economy of Thailand, and the recently integrated economies of China, Cambodia and Vietnam after their WTO accession to the economy of Laos with a modest extent of openness and even the isolated economy of Myanmar. Among others, two important aspects of the impact were a sharp increase in the inflation rate and decline of the GDP growth rate.

As of mid-2008, China, which was regarded as shield and buffer for Asia in the 1997 - 1998 crises, had felt the impact with a decline of exports, especially to the U.S, and a deterioration of domestic consumer demand. Inflation already rose by 7.1% in January 2008 - the highest level in more than a decade - urging Premier Wen Jiabao to proclaim tackling record levels of inflation as one of China's major tasks for the year (BBC News, 5/3/2008). China’s General Statistical Office reported in January 2009 that the Chinese economy only grew at 6.8% in Q4, compared to 9% in Q3 and 9.9% in Q1 whereas the average growth rate of 2008 was 6.8%, the lowest level since 2001.

In Thailand, growth diminished in line with the rising political conflict and the intensifying global financial crisis. The economic growth rate moderated from 6.0% in Q1 2008 to 5.3% and 3.9% in the second and third quarters, respectively. Headline inflation was on a downward path after peaking in mid-2006, but started to pick up in Q4 2007 on the back of escalating energy prices and food prices. In August 2008, the National Economic and Social Development Board (NESDB) even expected inflation to hit a 10-year high of 6.5 - 7.0% in 2008 (Thailand Economy Watch, 8/2008).

In April 2008, the National Bank of Laos confirmed that inflation rate already reached the level of 8%, increasing from 6.4% in February to 7.7% in March 2008 (VOA, 3/5/2008). The inflation rate still remained as high as 8.5% in September 2008 despite a decline in fuel cost (EIU, 12/2008). Nonetheless, the Lao economy was still able to grow at 7.9% in 2008 (Chanhming, 2009: 1).

Due to the contraction in almost all sectors of the Cambodian economy, real GDP growth dropped from 10.2% in 2007 to an average of 5.2% in 2008 (Hoang, 2009: 3). By end 2007, the y-o-y inflation rate already reached 10.8%, hitting a 9 year record high. The jump was driven by the increase in food (20%) and fuel (12%) costs and imported through the depreciating dollar (East Asia Update, 4/2008). The inflation hit 37.2% in the first half of 2008 and averaged at around 25% for the whole year (indexmundi.com).

The isolated Burmese economy also felt the pain of the global financial crisis. The commodity prices already skyrocketed in 2007, reaching up to 50% for that year (The
Irrawaddy, 26/12/2007). In 2008, foreign sources estimated that the inflation rate was at 26.8%, whereas the growth rate was merely around 0.9 - 1.1% (indexmundi.com).

In Vietnam, high inflation rate occurred in the last months of 2007, and increased dramatically in the first half of 2008. Contraction phase of the economy after a booming period occurred in Q1 and Q2 of 2008, and it was exaggerated by the impact of the global financial crisis, followed by the global economic recession. The average inflation rate of 2008 was as high as above 20%, compared to 12.63% in 2007. The economic growth rate also fell down from 8.6% in 2007 to 6.2% in 2008, and reached its trough in Q1 of 2009 at 3.1%.

Table 1. GDP Growth and Inflation of the GMS Economies in 2007 - 2008

<table>
<thead>
<tr>
<th>Country/Year</th>
<th>GDP Growth (%)</th>
<th>Inflation, average consumer prices (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambodia</td>
<td>10.205</td>
<td>7.668</td>
</tr>
<tr>
<td></td>
<td>6.692</td>
<td>24.997</td>
</tr>
<tr>
<td>China</td>
<td>13.012</td>
<td>4.767</td>
</tr>
<tr>
<td></td>
<td>9.007</td>
<td>5.92</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>7.458</td>
<td>4.524</td>
</tr>
<tr>
<td></td>
<td>7.221</td>
<td>7.628</td>
</tr>
<tr>
<td>Myanmar</td>
<td>11.934</td>
<td>32.926</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>22.5</td>
</tr>
<tr>
<td>Thailand</td>
<td>4.926</td>
<td>2.242</td>
</tr>
<tr>
<td></td>
<td>2.592</td>
<td>5.468</td>
</tr>
<tr>
<td>Vietnam</td>
<td>8.456</td>
<td>8.349</td>
</tr>
<tr>
<td></td>
<td>6.175</td>
<td>23.115</td>
</tr>
</tbody>
</table>

Source: International Monetary Fund, World Economic Outlook Database, October 2009.

The global shocks were transferred to the GMS countries through two major channels:

The first channel was through trade with the rest of the world.

A slowdown in the growth of world economies, especially the major trading partners of the GMS (i.e. U.S, Japan and EU), led to lower demand for GMS exports and tended to lower export prices and volumes.

It was reported that Cambodia garments export which was the main contributor to the Cambodian economy and accounted for 65% of Cambodian total export, was of 2.9 billions USD in 2008, compared to around 3.5 billions USD in 2007. In the first eight months of 2009, after the sharp reduction in the fourth quarter of 2008, garment exports declined almost a quarter year-on-year (Phnom Penh Post Newspaper, 13/10/2009). This decline was caused by the sharply lower spending by the consumers in the US and EU, the largest export markets for Cambodian garments (Hoang, 2009: 4). Total export growth of Vietnam in the first 9 months of 2009 also contracted to 13.8% compared to the same period of 2008 (thanhnien.com, 31/10/2009). China’s export value decreased by 22% in the first half of 2009 compared to the first half of 2008 whereas Thailand also experienced a contraction of 23% in export value during the first 5 months of 2009.

Declining terms of trade and fall of exchange rate further magnified the negative impacts of the global shocks on the GMS economies. For Lao PDR, the price of copper fell by 40%, leading to the reduction of copper export income by 60%. Export value of electricity price declined by 30%, textile by 10%, coffee price falls 18% in 2008 compared to 2007. Export value of corn declined as a result of the price fall (Chanhming, 2009: 2). Growers of cassava, however, were a little bit luckier because of high demand by Chinese companies despite a lower price than before. Previously, a ton of cassava would bring farmers 400000 kips (about 50 USD), but as of themed-2009, the price was only 320000 kip, a
20% drop (VOA News, 5/6/2009). To a similar fate, Thai rice export value was expected to drop by 20 per cent from 2008's value following lower agricultural-goods prices. As a result, despite ranking among Thailand’s top seven export products in 2008, Thai rice exports were forecast to drop 15 percent in volume to only 8.5 million tones in 2009.

Table 2. Goods trade balance in USD and as % of GDP

<table>
<thead>
<tr>
<th>Country/Year</th>
<th>Trade balance (million USD)</th>
<th>Trade balance (% GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambodia</td>
<td>-1382.1</td>
<td>-16.0</td>
</tr>
<tr>
<td>China</td>
<td>315381</td>
<td>9.3</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>-142.0</td>
<td>-3.5</td>
</tr>
<tr>
<td>Myanmar</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Thailand</td>
<td>11572</td>
<td>4.7</td>
</tr>
<tr>
<td>Vietnam</td>
<td>-10360</td>
<td>-14.6</td>
</tr>
</tbody>
</table>

Source: ADB (2009), Key Indicators for the Asia Pacific 2009.

Although for some GMS economies, the impacts had not been unraveled until the late months of 2008 and early 2009, and exports were still able to grow fast in 2008, there was already disadvantageous sign of increased trade deficit during 2008 (Table 2).

The second channel was through financial sector linkages.

In general, Asia's sub-prime losses in the crisis had been insignificant-less than 0.1% and in absolute value 19.5 billions USD (Nag, 2009). Asian financial institutions were by nature conservative and did not get involved with asset-backed securities. In addition, fundamental reforms of the banking sector that put emphasis on capital adequacy and credit rating - lessons learned from the 1997 Asian financial crisis - have served well Asian economies in the present crisis. For instance, nonperforming loans in Thailand during the peak of the crisis were over 25% - 30%, and these were around 5% in the current distress (Nag, 2009).

The impact of the global financial turmoil on the GMS economies was even of a more limited extent than other developing Asian economies because the GMS financial sector was underdeveloped and less integrated to the global financial system. In China, Yunnan and Guangxi financial institutions were only indirectly affected to some extent because the real economy had been assaulted. The decline of personal loans, manufacturing, transportation, storage and postal services, agriculture, wholesale and retail, mining, real estate and construction sectors had worsened the credit conditions of financial institutions (Lu Na, 2009: 2).

In Vietnam, since August 2008, foreign investors started to sell their owned stocks on the market, triggering a massive withdrawal by the domestic investors. Total foreign trading value on the stock market was of 41.076 billions VND in 2008, a loss of 38.5% compared to 2007. Net sale of stock decreased from 35.4% in 2007 to 19.4% in 2008. At the last trading day of 2008, Ho Chi Minh Securities Stock Exchange (HOSE) was closed with VNIndex losing 605.45 points, or 65.33% whereas in Hanoi Stock Trading Center (HASTC), HASTC Index lost 217.22 points, or 67.39% for the year.

The most developed and globally interconnected financial sector in the GMS is located in Thailand. Up to mid - October 2008,
the focal point was on the Stock Exchange of Thailand (SET) which saw its index plummet to the similar range as during the crisis of 1997. This scene did not create much anxiety among most of the population, considering that only less than 300,000 Thais out of 64 millions actively engage in the stock market. However, larger groups of the people felt risky since a number of saving schemes such as pension funds have their investment in the global equity markets. The capital of the Government Pension Fund which has more than 1.5 million officials as members, reduced by 14% in mid 2009 compared to one year ago. On liquidity, bank credit fell by 2.7% from December 2008 to June 2009. The decline largely reflects the fall in corporate loan demand on account of the slowing economy (Nijathaworn, 2009).

Table 3. Foreign investment in the GMS economies in 2007 - 2008

<table>
<thead>
<tr>
<th>Country/Year</th>
<th>Direct Investment (US million)</th>
<th>Portfolio Investment (US million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country/Year</td>
<td>2007</td>
<td>2008</td>
</tr>
<tr>
<td>Cambodia</td>
<td>866.5</td>
<td>805.8</td>
</tr>
<tr>
<td>China</td>
<td>121418</td>
<td>94320</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>323.5</td>
<td>227.8</td>
</tr>
<tr>
<td>Myanmar</td>
<td>572.2</td>
<td>N/A</td>
</tr>
<tr>
<td>Thailand</td>
<td>9381</td>
<td>7255</td>
</tr>
<tr>
<td>Vietnam</td>
<td>6516</td>
<td>9053</td>
</tr>
</tbody>
</table>

Source: ADB (2009), Key Indicators for the Asia Pacific 2009.

3. The responses from the GMS economies

Asian countries, including the GMS, by and large have been very responsive to the crisis and have taken important steps both on the fiscal side and the monetary side to support domestic financial systems and to boost up economic growth. The central banks reduced policy rates. Fiscal authorities adopted expansionary policies. Financial sector authorities took aggressive measures to stabilize their financial systems. Deposit guarantees were hiked with countries that did not have proper deposit insurance schemes instituting or extending them. Taxes were cut. Targeted cash transfers were made. In the early 2009, the Chiang Mai initiative announced a 120 billions USD swap reserve arrangement, up from 80 billions USD, essentially to assure Asian countries that they have access to a pool of money if needed. Counter cyclical fiscal stimulus measures taken by China, Malaysia, Singapore, and Vietnam exceeded five percent age points of GDP in size, while those of Hong Kong, India, Japan, Korea, the Philippines, and Thailand amounted to between two and five percent age points of GDP (Kawai, 2009a). These varied from country to country.
depending on fiscal space, but almost all countries have taken a few or some of these measures. Although it is difficult to estimate the actual impact of the above measures on GDP, the recent recovery seen in quarterly GDP growth recently suggests that these policy steps have been working for the GMS economies.

**Monetary and exchange rate policies**

Monetary policy was the first line of defense. With the global downturn and the precipitous drop in oil and other commodity prices, the inflationary concern, which preoccupied the GMS governments as late as July 2008, quickly dissipated. This gave monetary authorities plenty of room to reduce policy rates to support sagging demand. From October 2008 to June 2009, Thailand cut its 1-day repo rate four times, from 3.75% to current 1.25%, while Malaysia's overnight policy rate has fallen from 3.5% to current 2% (Kuroda, 2009). As soon as the inflationary pressure showed sign of easing in September 2008, State Bank of Vietnam decided to increase the interest rate of required reserve capitol by credit organizations from 3.6% to 5%, providing the room for these organizations to reduce lending rates. Since 1 February 2009, the basic interest rate was cut down to 7% from 8.5%(1). Since 1 March 2009, the required reserve ratio with respect to VND deposits was reduced from 5% to 3%, and this was applied to demand deposits and savings deposits (An, 2009: 4). The initial reaction by the Cambodian government was to increase the reserve requirements of commercial banks from 8% to 16%, but eventually reduced it to 12% after inflation conditions permitted some room for monetary easing. To prevent bad investments, the government also limited bank exposure to high-risk sectors, specifically real estate, by introducing a 15% cap on real estate lending (Hoang, 2009: 7). From August 2008 to December 2008, the People’s Bank of China cut its benchmark interest rate four times, from 7.47% to 5.31% (Tradingeconomics.com).

The vulnerability of the GMS economies to external shocks highlighted the importance of the choice of an exchange rate management in contributing to macroeconomic and financial stability. This requires prudent capital account opening, and consideration of the dynamic sequencing of capital market liberalization to ensure relatively stable exchange rates. Cambodia, Laos, Thailand and Vietnam are currently more or less under managed floating foreign exchange regimes. China adopted a relatively tightly managed US dollar-based regime (Tongurai and Toritani, 2009). It was evident that the US dollar was a preferable settlement currency in the GMS, both in domestic and foreign trades, and the pressures to increase exports plus inflationary pressure created the temptation to devaluate the local currencies against the US dollar (Kawai, 2009a). This was however a source of exchange rate instability during the financial distress.

In Vietnam, the exchange rate band has been adjusted several times since mid-2008 so that the exchange rates could fluctuate to reflect the supply-and-demand relation in the foreign currency market. For instance, on 27 June 2008, the band was raised to 2% from 1%, and up to 3% on 7 November 2008, then 5% since 24 March 2009. This legal band means that the exchange rate on free market is only allowed to fluctuate within 5% compared to the one on inter-bank foreign exchange market. In reality, the exchange rate was always on ceiling on free transaction market. This proved the imbalance between the demand and supply for foreign currency. Another reason was speculation and the expectation that VND would lose its value against the US dollar (An, 2009)(2).

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(1) At the latest move, on 1 December 2009, base interest rate increases from 7% to 8%, recapitalization interest rate increases from 7% to 8%, and discount rate from 5% to 6%. The aim of the increase was said to control the quality of credits by commercial banks and to be harmonized with the exchange rate policy.

(2) On 26 November 2009, the Government took a bold measure by increasing the interbank exchange rate band to
Thailand has adopted an inflation targeting regime since May 2000 after reappraising money supply targeting policy which was recommended by the IMF in the aftermath of the 1997 - 1998 financial crises. The main cause for change was that the relationship between money supply and output growth became less stable over time, particularly since the financial crisis. Although the policy may led to a decline of international competitiveness of Thai export products, it did help maintain the stability of the Baht against the US dollar during the 2008 financial turbulent compared to the time of the Asian financial crisis.

**Fiscal stimulus measures**

Fiscal measures were the next line of defense against the impact of global financial distress and economic recession in the GMS. Timely and well targeted stimulus packages have been in place and able to produce quick results thanks to their focus on the most good: "shovel-ready" infrastructure, small and medium-sized enterprises, rural economies, and social safety nets (Kuroda, 2009).

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 billions Kip to 10.648 billion Kip. While the additional money originally aimed to help the country recover from the damages caused by severe flooding in September 2008, it had important leverage effects on the demand side. In addition, Asian Development Bank also pledged to increase its financial assistance to the Lao PDR in the next two years, to help the country mitigate the impacts of the global financial crisis to enable its economy to recover by 2010 at the earliest. In 2008, the ADB already provided Laos a total of 53 millions USD in assistance that was used mainly to fund Laos’ poverty reduction projects in rural areas. For 2009, the Bank has allocated USD89 million to fund five important projects: improving the quality of higher education, developing public health services, improving production efficiency of small and medium businesses, developing and improving transportation and communication links between northern Laos and its neighbors in the GMS, and providing technical assistance to the Lao administration (VOA News, 8/1/2009). In addition, the stimulus effect also came from heavy investment on projects related to the South-East Asia Games that Laos host in 2009.

In January 2009, Abhisit's government announced a Bt116.7 billion (3.35 billions USD) stimulus package aimed at boosting the sagging economy hit by the airport blockade and by the global financial crisis. The whole package targeted at 17 stimulus and social-welfare projects, including raising welfare payments, cash handouts for low earners, expanding free education, handing out agricultural loans, and continuing the previous government's package for the poor including free public transport and subsidized electricity (The Nation, 5/5/2009). The second package namely "Thailand: Investing from Strength to Strength" (Patibudkarn Thai Kem-Kaeng) announced in May 2009 was worth USD45 billion aiming to revive the recession-hit economy in the longer run. It was said as a "twin-approaches" solution, by tackling both the short-term economic problems, and investing in long-term socio-economic capability and competitiveness. The package will be implemented over the next three years for investment in the long-overdue infrastructure projects such as roads, rails, communications, logistics, and water management and distribution system. Part of this fund will be used to upgrade our healthcare and education facilities and create centers of excellence in medical services. Thai service industry such as tourism will also get a bite at this fund.

5.44%, at the same time narrowing the US/VND exchange band to 3% from 5% to increase the ceiling of the exchange rate (now at 18,500 VND per USD).
In November 2008, China announced a 4-trillion yuan (585.5 USD) stimulus package that would be spanned for 2 years to boost up the economy. The plan that could be compared to the scale of the New Deal would spend money on upgrading infrastructure, particularly roads, railways, airports and the power grid; and raising rural incomes via land reform; and on social welfare projects such as affordable housing and environmental protection. The package also wrapped in some of the disaster reconstruction spending from the natural disasters such as last winter's abnormally severe weather and the Sichuan earthquake in May 2008. It tied together many policy initiatives already underway to close a potentially destabilizing income gap between the rich coastal cities and the poorer interior countryside (Forbes.com, 11/9/2008). In addition to the 4-trillion yuan package, in March 2009, Premier Wen Jiabao proposed a budgeted fiscal deficit of 950 billion CNY (139 billion USD) for 2009, a record high in six decades and nearly three times over the last record of 319.8 billions CNY set in 2003 (news.xinhuanet.com, 6/3/2009).

In December 2008, Cambodian lawmakers passed a $1.8 billion budget for 2009, increasing spending by a third from the 2008 budget (1.37 billions USD). The passage came after donor countries pledged USD950 million in aids, almost 40% more than they offered in 2008. However, the government has been under pressure to have a stimulus package following what have been done worldwide and in neighboring countries. In January 2009, opposition leader Sam Rainsy proposed a 500 millions USD stimulus package in order to help Cambodian economy overcome economic recession in 2009. 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 restricts its ability to provide economic stimulus. According to Finance Minister Keath Chhon, the government already subsidized electricity with 300 millions USD in 2008, and 450 millions USD went to the fiber industry. The government intervention already accounted for about 500 millions USD or 4.9% of Cambodia’s GDP.

In January 2009, the Vietnamese government announced the first stimulus package of USD1 billion. The package proposed a 4% interest rate subsidy for businesses and individuals within the period of 8 months till 31st December 2009. In May 2009, the details of the second stimulus package were officially informed by the Ministry of Planning and Investment with an aim to further spur growth amid deepening global recession. The second package was worth 143000 billions VND and included eight components: i) Supporting interest credit loans (about 17000 billions VND); ii) Suspending recover basic construction investment capital (approximately 3400 billions VND), iii) Spending on account state budget to complete some urgent projects (about 37200 billions VND), iv) Transferring plan investment capital from 2008 to 2009 (about 30200 billions VND), v) Issuing more Government bonds (around 20000 billions VND); vi) Carrying out tax reduction policy (approximately 28000 billions VND); vii) Increasing outstanding debt on credit guarantee for enterprises (about 17000 billions VND); and viii) Other expenses to stimulate demand aiming at stopping economic recession, ensuring social security (7200 billions VND) (Vneconomy.vn, 13/5/2009).

4. The prospective of the GMS economies and the implication for the GMS economic cooperation

Because of the lagging impact of the global recession, the first half of 2009 was a difficult moment for the GMS economies. The
prospective of growth for the GMS economies depended by and large on the external demand but the forecast of regional and global economies was dismal. In March 2009, World Bank reported that the world economy in 2009 would suffer a negative growth of 1.7%, with contraction occurring in all G3 (US, Euro Area and Japan) and world trade volume contracting by 6.1%. However, by the end of Q3, the overall situation has indicated the light in the end of the tunnel. Global recession seemed to pass its trough and showed a positive sign of recovery. This was the result of the combined global and national efforts to weather the crisis and stimulate the growth. Recent IMF report expected a more vigorous global recovery in the later half of 2009 with the growth rate of 3% in 2010.

The GMS economies have also performed better since Q3 of 2009. For example, the Vietnamese economy grew at 5.76% on the y-o-y basis compared to 3.1% and 4.5% in Q1 and Q2 respectively. China’s y-o-y economic growth accelerated to 8.9% in Q3 after tumbling to 6.1% in Q1 and reaching 7.9% in Q2 of 2009 (news.xinhuanet.com, 22/10/2009). The Thai economic growth in the third quarter expanded 2.3 - 2.5 per cent, compared to the second quarter but contracted 3.1 - 3.3 percent y-o-y.

Although the fundamental for recovery has not been consolidated, improving economic performance in the GMS has been contributed by timely and well targeted fiscal and monetary measures by the governments in the sub-region. The responses from the GMS economies to the global recession bear important policy implications for macroeconomic management and sub-regional cooperation.

First, like other Asian developing economies, the GMS economies rely too much on export and foreign investment as the sources of growth. There was remarkably synchronized nature of trade and investment contraction across countries in the sub-region, and this was generally consistent with their particular position within global and regional production networks. This kind of vulnerability may be even greater for such economies as Vietnam and Cambodia which have recently become the WTO member. Nonetheless, trading with neighboring economies is still very important for some countries in the GMS because of their disadvantageous geographical and political conditions. Laos, for example, being land-locked, depends on the intra-regional trade most, with 45% of its exports going to and 72% of its imports coming from other GMS countries. The U.S economic sanction has made Thailand and China Myanmar’s two largest trading partners. Geographical proximity also makes CLMV important trading partners of Yunnan and Guangxi provinces of China.

![Figure 1. GDP growth of the GMS economies, 2007 - 2014.](image)

*Source: International Monetary Fund, World Economic Outlook Database, October 2009*
Second, there has been congruence yet synergy in the policy responses as the countries across the sub-region adopted expansionary monetary and fiscal measures. In this respect, these policies were quite useful and necessary but limited because they have been largely national, independent, and uncoordinated, given that the GMS economies are increasingly interdependent with each other, not only in trade and investment, but also finance.

Indeed, there has been a “stimulus pressure” upon smaller countries with limited budget such as Laos and Cambodia who could 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 the benefit of the smaller economies, this should not be the condition for “free rider” incentive which leads to a smaller than desirable fiscal stimulus. So there is a case for more coordinated action and further deepening and integration of financial markets in the GMS to support the sub-region’s long-term growth. Financial cooperation will help reduce the sub-region’s financial risks and increase the sub-

![Figure 2](image-url)

**Figure 2.** Consumer price index of the GMS economies, 2007 - 2014.  
*Source: International Monetary Fund, World Economic Outlook Database, October 2009*

![Figure 3](image-url)

**Figure 3.** Current account deficit of the GMS economies, 2007 - 2014.  
*Source: International Monetary Fund, World Economic Outlook Database, October 2009*
regional influence in shaping the direction of the international financial system.

Third, although the risk of defection is always remaining high in a difficult moment, the GMS economies have not pursued a kind of beggar-thy-neighbor policy with an aggressive move to encourage exports through engineering currency devaluation and provision of favorable tax treatment for exports or discourage imports by raising tariffs to protect domestic industries. Nonetheless, given a more integrated labor market in the sub-region, the economic recession may spur the flow of cross-border migrant workers, therefore forcing the receiving country to tighten its employment policy on the migrant workers.

Fourth, there has been concern over the long-term effect of fiscal stimulus measures and the expansionary monetary policy. The GMS economies need to keep a watchful eye on medium- to long-term deficits and public debt, balancing fiscal stimulus with fiscal sustainability. They must ensure that the right money reaches the right person or money is channeled into “bankable” investment projects in infrastructure and other areas, rather than making a “round-trip” within the financial system of the economies. Although some part of fiscal resources may be directed to stabilizing output and employment in the short term through support of consumption and investment, a substantial part should be directed to laying foundations for long-term growth through, for instance, building credible social sector protection systems and promoting green industries.

Finally, as the response to the global recession, a number of economists recommended that Asian developing economies should look at ways to rebalance growth (Kawai, 2009a, 2009b). The GMS is no exception. That means the sub-region must become a market for its own production. The ultimate objective of growth rebalance is not to restore current account balance. Export-led growth of such market-oriented economies as those in the GMS may have surplus or deficit. Rather, rebalancing should focus on rectifying the bias of the incentive scheme in favor of particular sectors such as export-oriented industries. More importantly, rebalancing needs to remove the impediments to domestic consumption by increasing the purchasing power of those in the middle to lower part of income distribution.

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