

Narrowing development gaps through better governance in South-East Asia

The need to narrow gaps in economic development of South-East Asia is particularly pressing given that deepening of subregional integration structures to fully realize the ASEAN Economic Community has already begun. Failure to close development gaps would run the risk that the economies of the later-entrant countries – Cambodia, the Lao People’s Democratic Republic, Myanmar and Viet Nam (CLMV) may be overwhelmed by more developed neighbours and may not take full advantage of the opportunities emanating from integration. Narrowing the income and development gap will require measures that increase the availability and quality of physical capital, as well as improve workers’ skills and the availability of decent and productive jobs. In addition, there is a need to improve the economic fundamentals, wage and social protection systems and the effectiveness of fiscal policy.

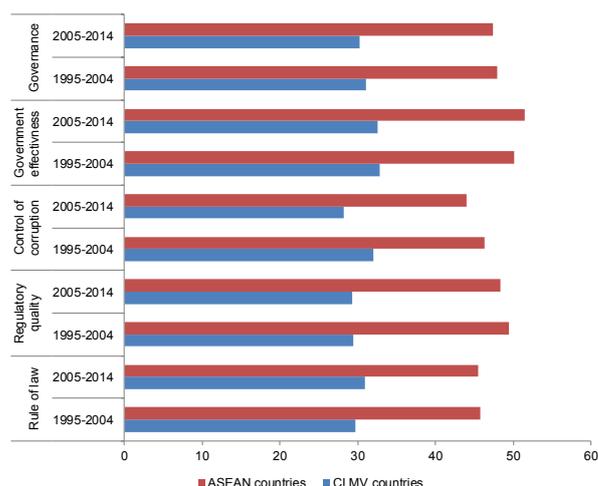
Development gap in the South-East Asian subregion remains wide. In income terms, the gap in the ratio of GDP per capita between the early-entrants of ASEAN and CLMV is large, although it has been gradually narrowing. The ratio stood at 10.6 in 2015 and 4.1 if the highest-income economy in the subregion, Singapore, is excluded. If concerted and coordinated measures are not taken to accelerate the narrowing of the income gap between the ASEAN-4 (Indonesia, Malaysia, Philippines and Thailand) and CLMV, it may take another 40 years to eliminate the gap completely.

Apart from income gaps, development gaps also exist in major socioeconomic areas. For instance, in the wake of technology-driven economic growth and the desire to integrate further into ASEAN, there is a need for CLMV countries to pay attention to their widening skills gap. Access to basic education has increased, but higher education and the quality of education remain a challenge. Similarly, while indicators of health in CLMV countries have improved significantly since 2000, the large gaps with other

ASEAN countries remain. Active policy interventions will be required to ensure that higher income growth translates into lower poverty, less income inequality and better social outcomes.

Improved governance and institutional quality in CLMV will have a critical role in closing the development gaps. There is a strong positive correlation between governance and institutional quality and economic growth and income levels. Analysis of World Bank Worldwide Governance Indicators that relate to the rule of law, regulatory quality, control of corruption and government effectiveness shows that CLMV performed more poorly in all of these governance dimensions than their non-CLMV ASEAN peers (see figure 1). Moreover, for most of the indicators there has also been little improvement over the two periods 1995-2004 and 2005-2014. Indeed, the control of corruption has deteriorated, whereas other indicators performance have largely remained unchanged apart from the rule of law, which has improved.

Figure 1. Governance indices in the CLMV group and ASEAN group, 1995-2004 and 2005-2014



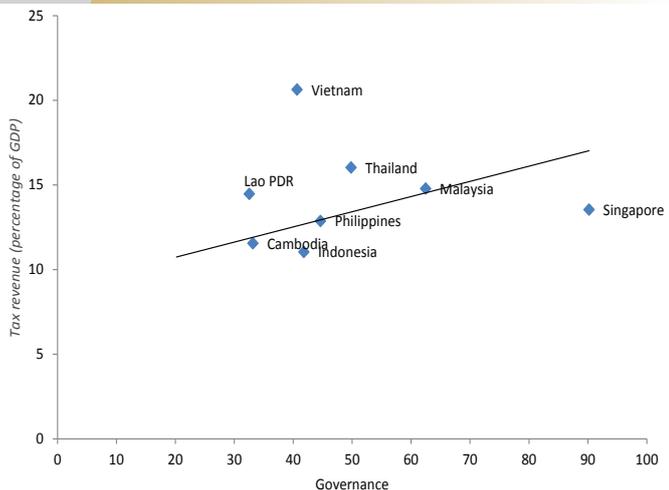
Source: ESCAP, based on Worldwide Governance Indicators (WGI) from Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi, "The worldwide governance indicators: methodology and analytical issues", Policy Research Working Paper, No. 5430 (Washington, D.C.: World Bank, 2010).

Note: Worldwide Governance Indicators have been rebased to 100. High values of the indices represent a good perception of the institutional quality. The index "governance" is the average of the four indicators.

The importance of governance for socioeconomic development in CLMV can be seen by considering some of the relationships between their development indicators and governance performance. One key concern for CLMV is financing their development needs. Apart from external development assistance, this involves increasing domestic resource mobilization from both the public and private sectors. In the public sphere, governance affects the ability of these countries to raise tax revenue, owing to issues such as corruption in tax collection and low tax morale due to perceived governance deficits. The relationship between lower governance performance and low tax revenues can be seen in the examples of Cambodia and the Lao People's Democratic Republic (see figure 2). Governance deficits can also affect the availability of private sector credit, which is important to support development objectives. The relationship between lower governance performance

Among CLMV, the greatest governance challenge is currently being faced by Myanmar. This is not surprising as the country has been in a transition process since 2010 involving economic and political opening. Good governance is especially important for attracting investors during the economic opening of the country as it attempts to diversify from a strongly natural-resource based economy. One of the key governance challenges is to increase bureaucratic efficiency. One way may be implement public sector reform. While public sector salaries have been increased rapidly in recent years, they still remain low, especially in comparison with newly available private sector jobs, including in foreign enterprises. The competition is highest in ministries with easily transferable skills, such as the Ministry of Finance and Revenue and the central bank.¹ Public sector reforms were initiated in 2013, with the formation of interministerial committees to simplify

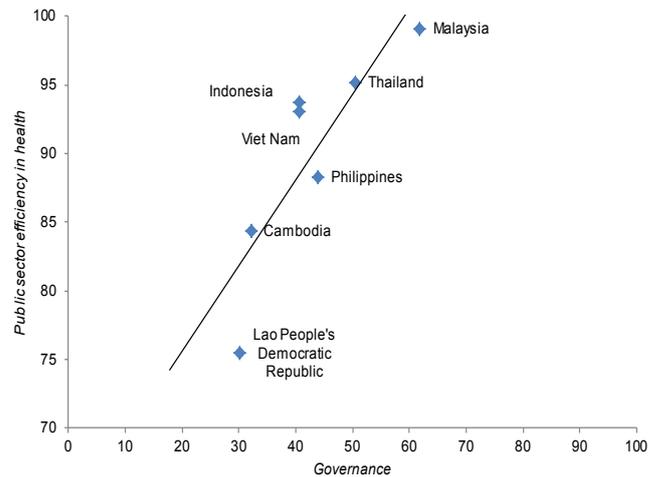
Figure 2. Tax revenues and governance in ASEAN countries, 2010-2014



Source: ESCAP, based on Worldwide Governance Indicators (WGI) from Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi, "The worldwide governance indicators: methodology and analytical issues", Policy Research Working Paper, No. 5430 (Washington, D.C.: World Bank, 2010).

Note: Tax revenue data is the average for 2009-2013 for Viet Nam.

Figure 3. Public sector efficiency in health and governance, 2005-2014



Source: ESCAP, based on Worldwide Governance Indicators (WGI) from Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi, "The worldwide governance indicators: methodology and analytical issues", Policy Research Working Paper, No. 5430 (Washington, D.C.: World Bank, 2010).

Note: Efficiency scores range between 0 and 100. An efficiency score which is equal to 100 would mean that the country is delivering the development outcomes by efficiently using the available resources.

and domestic credit to the private sector can be observed in the cases of Cambodia, the Lao People's Democratic Republic and Myanmar.

Another important relationship for CLMV is between governance performance and social development, especially in the critical spheres of health and education. The efficiency of the provision of health and education services is affected by governance performance, particularly through the channels of corruption and ineffective administration. For example, the relationship between lower governance performance and health sector efficiency can be seen in the cases of Cambodia and the Lao People's Democratic Republic (see figure 3).

coordination mechanisms, such as the National Energy Management Committee. However, these committees would be greatly aided in their work by having independent secretariats, as currently any policy proposals are returned to individual ministries for action. Another major challenge will also involve implementing effective decentralization of the bureaucracy. Although the 2008 constitution established state and regional governments, each with the power to levy taxes,² bureaucrats are appointed by the national Government. This creates conflicting powers of delegation for bureaucrats, especially with lines of delegation being further blurred by fewer line ministries at the regional level than at the national level, which results in multiple responsibilities.

The Lao People's Democratic Republic, while benefiting from good growth in recent years, remains the country with the lowest level of income per capita in the subregion. Governance issues remain a significant barrier to accelerated development, and may have increased in recent years, as the natural resources sector has grown and there has been an influx of foreign investment. However, the government has been active in attempting to counter the problem through legislative action: in 2009 it ratified the United Nations Convention against Corruption and in 2012 established an anti-corruption law. The State Inspection and Anti-Corruption Authority, which started working on investigation of corruption cases in 2014, would, however, benefit from further capacity development and specific investigative training. Currently, there is also underutilization of the criminal justice system in addressing governance issues, with the authorities traditionally dealing with them through internal inspections but a few cases have been brought to court. Other challenges concern bribery and embezzlement in the private sector, which still have not been criminalized; and inconsistencies between the penal code and the anti-corruption law.³ The country would also benefit from enhanced capacity for citizens and businesses to denounce corruption cases through advocacy, education and the improvement of the interface between citizens and the State Inspection and Anti-Corruption Authority.

Cambodia, another fast-growing country in the subregion, faces a particular challenge compared with its neighbours in terms of performance under the rule of law. Some of the key elements are judicial independence and enforcement of the law. The Government has undertaken various legal and judicial reforms, such as the "Rectangular Strategy", which is centred on good governance and has key programmes on legal and judicial reform and fighting corruption, among others. The Government in 2010 created an anti-corruption unit in the Cambodia National Police. However, challenges remain in implementing legislation effectively. There are concerns that inefficiency, lack of training and lack of independence have had adverse impacts on the judiciary. Economic development is also affected by this situation

with regard to property rights, with a key area being land acquisition.⁴ The country suffers from a lack of capacity across all sectors of the judicial system, including enforcement and the judicial, where salaries and available resources remain low. While the creation of the anti-corruption unit in the Cambodia National Police is a positive step, more can be done to increase the accountability of the justice system to the general public.

Viet Nam should undertake more regulatory reforms to pave the way for the economy to move to upper-middle-income status. The Government has undertaken ambitious reforms recently: the Government also issued 50 decrees clarifying guidelines for enterprises and removing about 3,500 regulations, the most ambitious cutting of red tape in the country.⁵ However, further work is required to reduce administrative burdens, overcome human resources constraints and simplify an overcomplicated, restricted and unclear licensing and regulatory environment.⁶ Particular actions which should be taken include improving the administrative environment through the simplification of laws and administrative procedures, reducing the scope for abuse by clarifying regulations and improving the pay of State employees and avoiding approving retroactive laws. Among specific regulations, those regarding tax should be revised in order to spur the growth of private enterprise and attract more foreign investment.

While many of the measures to alleviate these governance challenges will have to come through national policies in CLMV, policy coordination at the subregional level can also play an important role through the assistance of ASEAN. Actions that ASEAN could take include monitoring the relative governance performance of CLMV using readily available data, establishing strategic capacity-building and knowledge-sharing activities that target existing gaps and complementing national programmes. Another action includes establishing a more focused approach in capacity development programmes that target gaps in CLMV public services that are not being addressed through national programmes. CLMV could work closely with ASEAN counterparts to identify these gaps.

¹ Cullen Hendrix and Marcus Noland, “Myanmar: cross-cutting governance challenges”, Economics Working Paper, No. 428 (Manila, Asian Development Bank, 2015).

² David Hook and others, “Conceptualizing public sector reform in Myanmar”, (Myanmar Development Resource Institute’s Centre for Economic and Social Development (MDRI-CESD) and the Asia Foundation. June, 2015). Available from <http://asiafoundation.org/resources/pdfs/PSRFullreportENG.pdf>.

³ United Nations Office on Drugs and Crime (UNODC), “Supporting Lao PDR to pursue sustainable growth through corruption eradication”, 8 April 2016. Available from www.unodc.org/southeastasiaandpacific/en/what-we-do/anticorruption/topics/04-lao-corruption.html.

⁴ Michael B. Dwyer and Young Sokphea, “Uneven developments towards inclusive land governance in contemporary Cambodia”, Working Paper, No. 476 (Brighton, United Kingdom, Institute of Development Studies, 2016). Available from www.ids.ac.uk/publication/uneven-developments-toward-inclusive-land-governance-in-contemporary-cambodia.

⁵ Steve Morrish, “Building rule of law for the next generation in Cambodia”, 12 November 2016. Available from www.linkedin.com/pulse/building-rule-law-next-generation-cambodia-steve-morrish.

⁶ Chau Hoang, “Vietnam’s new Prime Minister quietly turns the wheels of economic reform”, 23 August 2016. Available from www.cogitasia.com/vietnams-new-prime-minister-quietly-turns-the-wheels-of-economic-reform/.

⁷ Tri Thanh Vo and Cuong Van Nguyen, “Towards responsive regulatory management systems: country report for Viet Nam”, ERIA Discussion Paper, No. 2016-22 (Jakarta: Economic Research Institute for ASEAN and East Asia, 2016). Available from www.eria.org/ERIA-DP-2016-22.pdf.

The MPFD Policy Briefs aim at generating a forward-looking discussion among policymakers, researchers and other stakeholders to help forge political will and build a regional consensus on needed policy actions and pressing reforms. Policy Briefs are issued without formal editing. This issue was prepared by Shuvojit Banerjee. This policy brief benefited from comments by Hamza Ali Malik, Naylin Oo, Oliver Paddison, and Vatcharin Sirimaneetham. For further information on this issue, please contact Hamza Ali Malik, Director a.i., Macroeconomic Policy and Financing for Development Division, ESCAP (escap-mpdd@un.org).

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