

# A Study On Economic Cooperation Mechanism in Greater Mekong Subregion: an Analyzing Framework of Transaction Cost

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## Abstract

Over the past 17 years, the Greater Mekong Subregion (GMS) economic cooperation has made good progress, building the trust and confidence among member countries and improving the subregional inter-state relations. Many economists have studied the Greater Mekong Subregion economic cooperation, but very few scholars explored deeper into the internal mechanism of cooperation. In this paper, the writer puts forward a new framework of subregional cooperation theory by using the theory of basic transaction cost economics combined with subregional characteristics of their own. Then the writer briefly analyzes the driving force of the Greater Mekong Subregion economic cooperation, and puts forward theory support and policy recommendations for GMS cooperation.

**Key Word** : Greater Mekong Subregion Economic Cooperation ; Transaction Cost; Institutional arrangement

## 1. Introduction

### 1.1. Introduction for GMS economic cooperation

The Greater Mekong River is an important international river in Asia, which is called Lancang River in the region of China and Mekong River outside of China. It's source is in the Tibetan mountains and it passes through the South-Western part of China, Yunnan province, Burma, Laos, Thailand, Cambodia, Vietnam and then flows into the South China Sea near Ho Chi Minh City.

The Greater Mekong Subregion (GMS) comprises Cambodia, the People's Republic of China, Lao People's Democratic Republic, Myanmar, Thailand, and Vietnam. GMS is a land bridge which

connects with China, Southeast Asia and South Asia. The total area this region is 256.86 million square kilometers, with a total population of about 320 million. This region has great economic potential and development prospects, is rich in water resources, biological resources, mineral resources. However, most parts of the basin's economy and society developed slowly during a long time, and most countries are members of the world's poorest countries.

The Greater Mekong subregional countries are reforming economic system, adjusting the industrial structure, accelerating its step in opening to the outside world, and accelerating economic development has become the common goal of all countries. In 1992, with ADB's (Asia Development Bank) assistance, the six countries entered into a program of subregional economic cooperation, designed to enhance economic relations among the countries. The program has contributed to the development of infrastructure to enable the development and sharing of the resource base, and promote the free flow of goods and people in the subregion. It has also led to the international recognition of the subregion as a growth area. The GMS Program has accelerated economic cooperation among the six member countries and the first ever the GMS Summit of Leaders was held in Phnom Penh in November 2002. Since then, GMS summit is held every three years and have been held 3 times now.

In recent years, GMS cooperation focusing on five strategies, that is, the construction of infrastructure, cross-border trade and investment, private sector participation, human resource development, environmental protection and sustainable use of natural resources, achieved gratifying results. The GMS countries are becoming increasingly closer in politics, economy, cultural and other fields. Increased connectivity will lead to greater economic opportunities, which will assist reducing poverty.

## 1.2. Literature Review

Since the end of the 20th century, along with the globalization of the world economy and regional economic integration, a constant wave of development subregion economic cooperation forms appear as a new type of cross-border economic cooperation.

Many scholars began to study this new type of cross-border economic cooperation, and achieved some good results. Sir Arthur Gaitskell (1973) analyzed strategy choice of Southeast Asia subregional economic development, the Mekong River as an example.<sup>1</sup> Medhi Krongkaew (2004) analyzed the cooperation of six participating countries, such as transport, telecommunications, energy and tourism cooperation, and so on. He noted that, However, there are problems concerning the different levels of development, and the relative lack of political stability in some member countries that may slow down the progress and full benefits of this subregional cooperation, the potential benefits from this cooperation are large.<sup>2</sup>

Ding (2001) holds that the subregion economic cooperation is small-scale, and has been recognized as a separate economic region, cross-border multilateral economic cooperation. Li (2005), from the view of human geography, using synthetically theory, discloses the impact of border, effect of border and location of border. He notes the impact of border to transborder economic cooperation include shield effects and agency effects, the shield of border increase the transaction, whereas the agency effects of border make the border region a firms centralizing areas.

In addition, under the background of China's participation in the Greater Mekong Subregion Economic Cooperation, in studying of examples, some scholars in China analyze the coming opportunities and challenges in the process of economic cooperation. These literatures and monographs are relatively abundant.

Wang Qin (2004), on the basis of the progress of China's participation in the Greater Mekong Subregion Economic Cooperation, figures subregion economic cooperation is facing unprecedented opportunities for development. Wang (2006), from the perspective of international relations, exploring the relations between GMS countries after he post-cold War, analyzes that the GMS economic cooperation play an active role in the construction of "harmonious region". Mei (2007) thinks it is an opportunity for small and medium- sized enterprises to participate in GMS.

To sum up, many economists have studied the Greater Mekong Subregion economic cooperation, but very few scholars explore deeper into the internal mechanism of cooperation, the results are mostly concentrated in the objectives, features, policies and measures.

Because of lack of theoretical support and practical reference, it's hard for us to find a suitable model of development. The Greater Mekong Subregion economic cooperation gets on slowly in recent years. The relationship of Southeast Asia's politics and economy is very complicated, simply relying on traditional theories of regional economic integration and international trade is inadequate for us to study this subregion cooperation. From a new perspective, this paper attempts to analyze the driving force of the Greater Mekong Subregion economic cooperation by using the theory of basic transaction cost economics combined with subregional characteristics of their own, and then put forward the participation theoretical support and policy recommendations.

## **2. On the basis of transaction cost economics**

### **2.1. The concept and definition of transaction cost**

Coase (1937) described the idea of transaction cost in the book "The Nature of the Firm". He said "There is a cost of using the price mechanism. The most obvious cost of 'organizing' production through the price mechanism is that of discovering what the relevant prices are. This cost may be

reduced but it will not be eliminated by the emergence of specialists who will sell this information. The costs of negotiating and concluding a separate contract for each exchange transaction which takes place on a market must also be taken into account”.<sup>3</sup> Coase (1960) defined transaction cost “one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed”.<sup>4</sup>

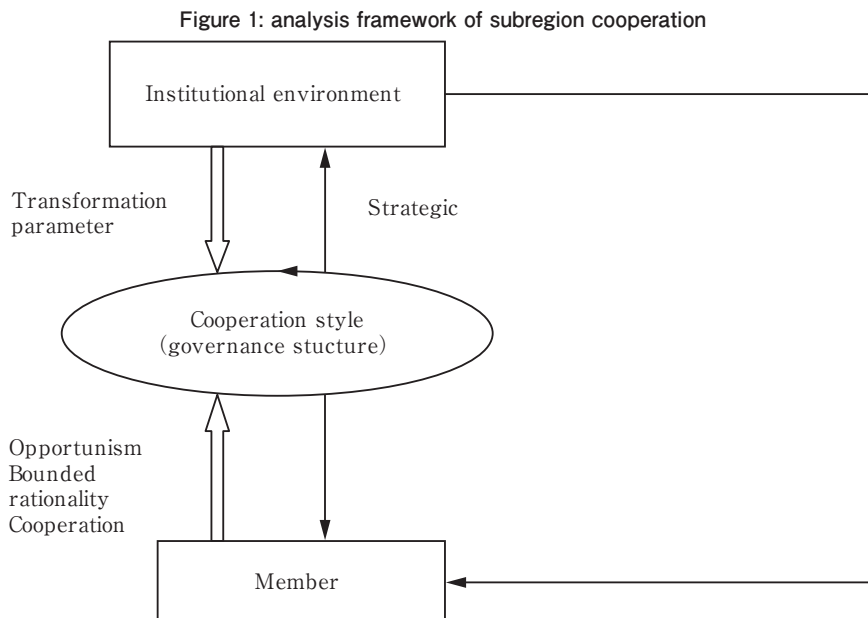
Kenneth Arrow (1969) has defined transaction cost as the “costs of running the economic system”.<sup>5</sup> Williamson (1985) “Transaction costs are the economic equivalent of friction in physical systems. Transaction costs include ex ante and ex post types.”<sup>6</sup>

Zhang Wuchang (1999) believed that transaction cost was seen as a series of system cost, including information costs, negotiation costs, the drafting and implementing contract costs, the cost of defining and implementing ownership, supervision and management costs and the cost of changing the institutional arrangements. In short, it included all non-direct costs that happen in the process of material producing.<sup>7</sup>

Although the concept of transaction costs is not formed an authority definition, and the scholars' expressions are different but the same in essence, the transaction cost theory has been widely used.

## 2.2. Framework

On basis of Williamson's three-story in the analytical model, the writer builds a subregion eco-



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nomic cooperation framework (Figure 1).

Institutional environment includes international political and economic situation, political system of members, level of economy development, trade policy and human geography, and so on. That is the basic factor to consider when carrying on subregional cooperation between countries.

Institutional environment and members together affect cooperative or not between countries. On the one hand, in a good environment system, the desire for cooperation between countries enhances; contrarily, it can't shape subregion cooperation because of lack of desire for collaboration. On the other hand, due to members having three characteristics we mentioned above, members require to cooperate to pursue their own political and economic interests. Once the system is running, performance is the beginning of subregional economic cooperation. Institutional environment will affect comparative costs (transformation parameter) of the cooperation form (governance structure). The behavior of member's bounded rationality and opportunism will produce transaction cost of economic cooperation. Then, different cooperation form (governance structure) in turn influences conducts of members, and different members' conducts will form different transaction costs.

Therefore, as shown in Figure 1 is a cycle system. The ameliorative institutional environment leads to sense of cooperation enhanced, later, regional economic cooperation organization gradually builds up. After system established, transaction costs should reduce continuously so as to maintain the stable operation of the system. Otherwise, cooperation is not sustained. The transaction costs of cooperation will reduce when we choose a reasonable cooperation form and institutional environment, moreover economic cooperation will be carried out smoothly. Favorable cooperation will not only impulse economic development for members, but influence political and economic situations and improve the institutional environment of members countries, which in turn will strengthen the desire for a higher level of cooperation. In this way, Favorable subregional economic cooperation system will run smoothly, and will promote subregional economy cooperation to a higher level.

### **3. The driving force mechanism of GMS cooperation**

We have explained the fact that favorable institutional environment and desire of all members for cooperation are the major reason for the enhanced sub-region economic cooperation. Now, let's come to the power mechanism of the Greater Mekong Subregion cooperation.

#### **3.1. The fundamental power for subregion cooperation**

The regional situation is stable and the economic globalization is irreversible. The fundamental power for subregion economic cooperation is economic globalization, regional economic integration and the world peace and development. Since the 1990s, the cold war has been over, the regional po-

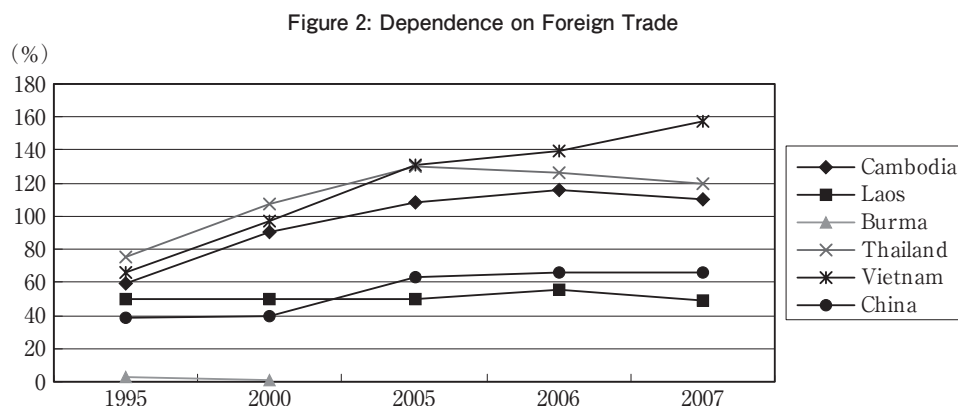
litical situation has changed, and peace and development have become the mainstream of the world, and never-seen peace and stability have appeared in the Indo-China Peninsula. Currently, the theme of the development of the subregion situation is peace, stability, cooperation and development.

Regional economic integration and economic globalization have promoted the growth of trades between countries, deepened specialized production and enhanced country-to-country dependency. Under such background, economic development and strength competition between the countries have been increasingly showing the regional features, which means we are one and we are mutual-dependent, and any country cannot break away from the regional community and development by itself. Following the main trend of economic globalization and regional economic integration, all of the six countries along the Greater Mekong River are committed themselves to improving environment for international investment ,and attaching great importance to developing mutual good-neighboring relationship and economy and trade. It is our common goal to promote national economic development, achieve common prosperity and enjoy rapid growth in the world economy.

### 3.2. The realistic basis for cooperation

Affected by such factors as foreign invasion and civil war, countries of Mekong Subregion suffer relatively backward economic and social development, with Burma and Laos being listed as two of the least developed countries by the United Nations. For the past few years, all countries of the subregion have been carrying out economic reform, readjusting industrial structure, and expanding the level of opening to the outside world. Therefore, the whole region has been enjoying a rapid economic growth and increasing volume of trade.

Generally speaking, countries of the Greater Mekong Subregion are highly dependent on foreign trade (Figure2), with Thailand, Vietnam and Cambodia all over 110% in terms of ratio of dependence on foreign trade, and are deepening their economic opening up. Foreign trade volume of these



Sources: Asian Development Bank (ADB)- Key Indicators 2008

Figure 3: Growth rate of trade

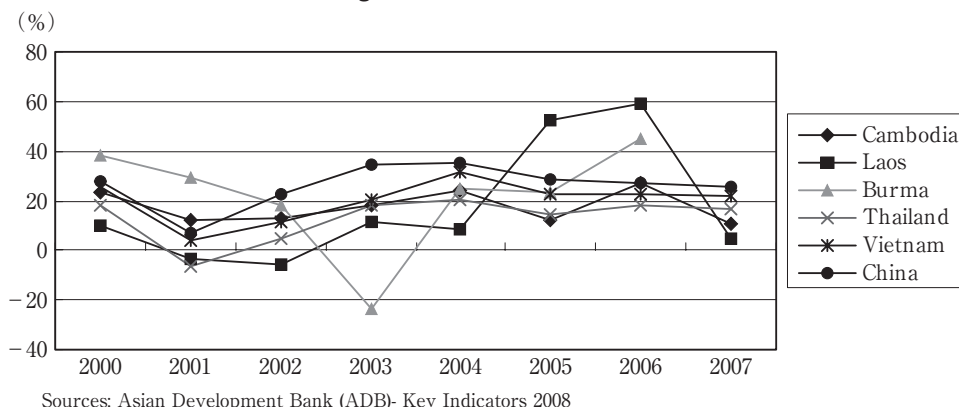
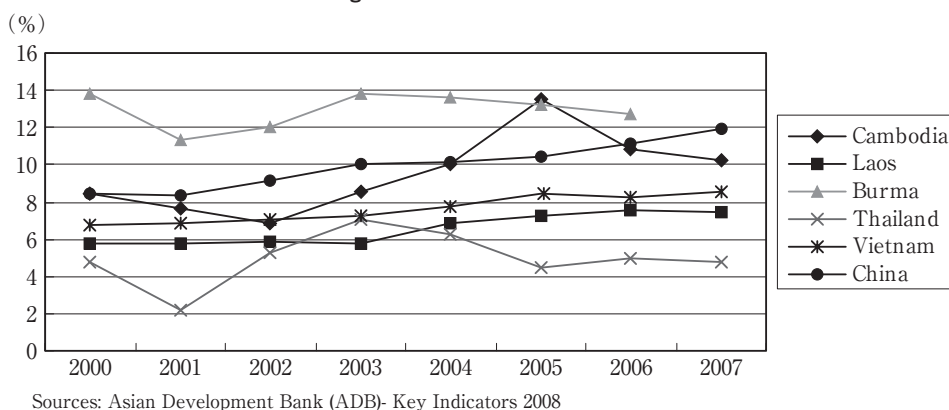


Figure 4: Growth rate of GDP



countries has also been increasing gradually (Figure 3).The improvement of both the level and volume of the trade has strengthened the economic relation of the subregion. For the past few years, all countries of the region have been enjoying economic growth (Figure 4), and the gap of economic volume is narrowing. Rapid growth of economic and trade volume is the realistic basis for cooperation.

### 3.3. The economic basis for cooperation

The complementarity of resource and economy forms the economic basis for cooperation. The subregion, with rich resources of water, biology and minerals, enjoy favorable natural conditions, and are of great economic potential and exploitation value. Yunnan is rich in water power, nonferrous metal, phosphorite, temperate fruits and vegetables and the processed goods, as well as specialized tourism resources. Vietnam has a large storage of coal, iron and aluminum, produce a large amount of rice, tropical cash crop and tropical fruits, and enjoy rich resources such as forest, water, and off-shore fishery. Thailand has lots of sylvite, tin and lignite, and it is a major rice producer and exporter. Burma, with 34,120,000 hectares of forests and coverage of 50 %, is NO.1 teak producer in the

Table 1: percent of industry values in GDP (%)

	agriculture	Industry	service
Burma	48.4	16.2	35.4
Cambodia	31.9	26.8	41.3
Laos	42.6	31.8	25.6
Thailand	11.4	43.9	44.7
Vietnam	20.3	41.6	38.1
China	11.3	48.6	40.1

Sources: Asian Development Bank (ADB)- Key Indicators 2008

world. Laos has rich water resources and produces high-grade wood such as teak and rosewood. Cambodia owns rich resources in forestry, fishery and animal husbandry. The complementarities of resources and diversity of cooperation is bound to further the over-all exploitation of the dominant resources of the subregion.

In this region, there is emerging marketing economy such as Thailand as well as transforming economies such as Vietnam, Burma, Cambodia and Laos, and they quite vary in terms of economic scale. Countries of the region are quite different in the level of economic development and industrial structure. For example, China boasts comparative advantage in steel production, Vietnam and Laos in hydroelectricity production, Burma and Thailand in wood production. To achieve common development is the fundamental goal of cooperation.

### 3.4. Eager desire for cooperation

Most countries and areas of the Greater Mekong River Subregion have been suffering slow economic development, and it is the common desire to make full use of the resource advantage, promote economic development and get rid of poverty as soon as possible. Countries of the region have natural geographical and humanity advantages; they are harmonious neighbors and all are developing countries. Now, the relationship between the six countries has become closer and closer, the common need is becoming more and more, the common interest has been broadening and the desire for cooperation is unprecedented eager.

The five countries along the lower course of the Mekong River, despite of rich resources, are all developing countries. Among them, Thailand enjoys a relatively good economic situation, but the others are economically backward. Therefore, none of the countries can exploit the resources by itself, and an organization for cooperation is badly needed. The level of development of the sub-region is low as a whole, and highly dependent on fund, technology and market from outside the region. Only by transnational cooperation can they better attract foreign investment and aid. Since

reform and opening up, China's economy has grown at a high speed while the other five countries have remained weak, and they are suspicious of China. Located in the upper course of the Mekong River, China has natural advantage of exploiting and using the resources of the basin while the other countries are passive. Under the framework of economic cooperation of the subregion, all countries, in accordance with the international rules, can exploit the resources on a reasonable, equal and mutual-beneficial principle.

All countries of the subregion have strong anticipation of the profits of the cooperation, including the political anticipation of creating a peaceful and stable external environment for national economic development and entering into regional affairs thus avoiding being isolated by the international community, and the anticipation of striving for more attention and assistant fund from the international community. The strong anticipation of the profits of cooperation has enhanced the desire for regional cooperation.

#### **4. The analysis of transaction cost in GMS cooperation**

Transaction costs result from a kind of unbalance between knowledge and information among economic bodies. It is the loss to social wealth and resources during conflict and mediation of interests. Those economic bodies do not only have unbalanced information, but also have discrepancies in terms of division of labor as well as space and time, which have caused the discrepancy between knowledge and checked individuals. Conflicts of interests between economic bodies give an opportunity to opportunism to utilize those discrepancies among information, knowledge and experience. As a result, transaction costs grow higher rapidly.

During the participation of GMS cooperation, it is impossible for each country considered as economic bodies to master all the information, or make sure what they have mastered is unbalanced. Therefore, limited rationalities of economic bodies and those actions of opportunism would make transaction costs during economic cooperation higher and higher. On the one hand, it may increase the costs spent on information collection during the communication of economic bodies, and that spent on supervision and management as well as change of institutional structure. It may induce misunderstandings among member countries and aggravate the distrust and insecurity between each other; On the other hand, transaction costs of high level may also decrease or eliminate those economic actions that used to be important, and even cause some regional organizations involved not able to run normally as before.

Discrepancies always exist between China and many countries of subregion in terms of political system, ideology and values. Especially being regarded as a great country, China has shown her rapid economic development in recent years to the whole world. As a result, China Threat Theory is

spreading over these countries. Those countries which lie downstream of Langcang River think that large number of dams and hydropower stations built by China on the river may bring certain influences to the water flows of Mekong River downstream and damage the environment there, which has interrupted the normal life of the people there. However, China has already sent experts to make researches and investigations and taken necessary measures before the dam projects started. China insists that those dams built on the Langcang River are not just used to generate electricity, but also helpful for regulating the water flow of the whole river so as to avoid serious flood and drought. Vietnam, Laos and Cambodia have been trapping in hostile relationship for years, what's more, Thailand has been involving in territorial dispute with Laos and Myanmar respectively for many years and even armed conflicts frequently happen on the border lines. All of the above are due to the increasing of the costs for cooperation caused by incomplete and unbalanced information.

Establishment of the subregional cooperative organization can rely on interiorization of market by state contract to decrease the transaction cost of economic cooperation. However, establishment and running of economic integration can be also deemed as one kind of transaction activities among member countries. Therefore, resources may be consumed and then certain costs shall be paid for that. And once the transaction costs used for running of subregional cooperative organization have exceeded those profits gained from subregional cooperation by each country (no matter subjective or objective), economic cooperation in this kind of subregional organization will not probably be continuous. After the subregional organization is established, in order to protect their own interests during economic communication, each country is inclined to depend always on others and do something unprincipled that may slow down the steps of subregional cooperation. As a result, supervision and management costs increase. For example, many regional organizations actually survive in name only in the world at present. Or else, the subregional economic cooperation can be high valuable and helpful for promoting economic development of each country and even enlarge the space and constantly improve the unionization degree of economic integration.

Therefore, systems that make information cheaper, policies that narrow the space and decrease the time and people's improvement of ideology, anyone of them may be helpful for the reduction of transaction costs. When we have chosen proper regulation and structure for the transaction needed to be finished, the transaction costs needed may be reduced, otherwise higher costs shall be paid and even the transaction may end up with failure.

According to the analysis above, the writer comes to a conclusion that the subregional cooperation is such a kind of regional cooperation that happens among those countries or regions that are adjacent to or near from each other geographically. They need to start communication and cooperation in multiple fields under a certain kind of system with the improvement of environment and reinforcement of cooperative intentions. The purpose for this kind of cooperation is to accelerate the de-

velopment and improvement of member countries and then realize the political and economic profits for each one. Meanwhile, subregional cooperation is such a kind of dynamic process that needs to reduce transaction cost continuously.

## 5. Suggestions for GMS cooperation

From the above analysis, transaction costs are the important factor for GMS cooperation. Although the transaction costs can not be completely eliminated, they could be reduced. In New Institutional Economics, the system and technology are the two main forces to reduce the transaction costs.

ADB takes a catalytic role in initiating and building the GMS Program, encouraging and supporting member countries with technical expertise while providing its own funding and leveraging that of other agencies. Having achieved a measure of success, ADB must now lead the GMS program to move to the next level of maturity where its members take on more responsibilities. China, the only big country in the Greater Mekong Subregion, should also play an important role to maintain the normal operation of GMS cooperation.

### 5.1 To form a good institutional arrangement

An important function of system is to reduce transaction costs, and institutional innovation is aimed at continuously taking from transaction costs. Effective system can reduce the uncertainty in the market and curb the opportunism of economic actors. Consequently, it tends to reduce transaction costs.

All the GMS counties are developing countries except Thailand which is a newly industrialized economy. Especially, Laos, Cambodia, Myanmar are the poorest counties in the world. The size of the internal market in GMS is limited, the market economy is immature. At present, low-level sub-regional cooperation institutional arrangement is suitable for GMS. For example, we can adopt preferential trade agreements, facilitation of investment and trade and multi-field cooperation. Because low-level economic cooperation is easy to coordinate and monitor, and it needn't make concession in national sovereignty. Some of the GMS countries are undertaking political and economic reform, thereby it can bring too much risk and transaction costs owing to transferring sovereignty.

Trade facilitation should first focus on simplifying customs procedures at selected border crossings. China as a responsible big country, its economy develops rapidly, and national image and status upgrade gradually. China's single stop customs inspection systems will be refined and replicated in other counties. Subsequent phases of cooperation will cover transparency customs procedures. GMS should contribute to creating a favorable environment for private firms, especially for small and

medium-sized enterprises.

A good institutional arrangement should be able to overcome opportunistic behavior of members and make sure continuous cooperation and cooperation gains. GMS countries have their own interests; moreover benefits of cooperation are apparent or recessive, big or small, short-term or long-term, so it is very important to coordinate the interests of all countries. To this end, subregional cooperation should reflect the principle of giving priority to the development region which is transparent and mutually beneficial.

## 5.2 Establishment of infrastructure and information platform

Cross-border and domestic transport infrastructure together can reduce trade costs and lead directly to increased trade and investment. GMS transport facilities are very backward, and it has become a major obstacle for the development of GMS. Despite substantial progress over the past decade, GMS still faces many constraints that restrict both passenger and freight transport flows, particularly cross-border flows. Improved infrastructure provides an important basis for GMS economic and social development. The region needs to continue to implement cooperation projects on transport, accelerate the construction of transport links along the North-South, East-West and Southern corridors, further develop shipping infrastructure and the information super-highway.

In the lead of ADB, member countries should strengthen cooperation and promote the foundation of subregional traffic network. Some countries with lack of funding are slow to implement the construction of infrastructure and road link. Road, railways and waterways should be speeded up in order to connect Yunnan and other member countries. These projects will enhance economic development of riparian countries. The ADB should lead members to enhance infrastructure construction. The improvement of transport will reduce transport costs, and then communication and cooperation among countries will be more closely.

It is necessary to establish a resource sharing and information open platform. The platform can be a form of network and can also be a form of exchange. The content of this platform could include information of political, economic and cultural of members as well as relevant information about subregional cooperation. Open and transparent information can eliminate the mutual mistrust, which tends to reduce opportunistic behavior and moral risk.

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