Research Article

Will South Asia Benefit from Pan-Asian Integration?

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Abstract

This article examines the gains for South Asian economies from integrating with East Asia and India's role in this process. Evidence of increased pan-Asian integration exists but the process is uneven. Bilateral trade has grown. Bilateral foreign direct investment flows and free trade agreements (FTAs) have also increased, albeit at a slower pace than trade. The integration process has been led by India and Pakistan with limited participation of smaller South Asian economies. Tackling key impediments in infrastructure, FTAs, trade barriers and business regulations, and barriers to services will foster further integration. Computable general equilibrium simulations suggest that a South Asia–East Asia FTA offers the most gains for South Asia and that India has an incentive to include its neighbours in such an arrangement rather than going it alone with East Asia. The rest of South Asia will gain by deepening South Asian integration and fostering ties with East Asia.

JEL: F15, F17, O14, O24, O53

Keywords

Economic integration, computable general equilibrium, trade policy, industrialization, Asia

Introduction

There is heightened policy interest in pan-Asian economic integration involving South and East Asian economies.[1] India's Look East Policy of 1991 signalled its intent to revitalize the civilizational, defence and economic ties with globally-important East Asia (Asher & Sen, 2008). India has a plurilateral free trade agreement (FTA) with the Association of Southeast Asian Nations (ASEAN) as well as bilateral FTAs with Japan, Korea and Singapore. Negotiations are also

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under way for the large regional comprehensive economic partnership (RCEP) involving India, East Asian economies, Australia and New Zealand. Furthermore, the new Indian Prime Minister, Narendra Modi, has a pro-business reform agenda, and some speculate that Indo-Japan ties will become the main driver of India's Look East Policy.

Pan-Asian economic integration has sparked a growing public debate about its economic impacts on South Asian economies. This article addresses two related policy questions in this debate: Will South Asian economies benefit from integrating with East Asia? And, are there economic grounds for India to include its South Asian neighbours in the process? This article seeks to improve our understanding of the economic implications of pan-Asian integration for South Asia, and contribute to the sparse academic literature on the topic.[2] It analyzes trade and foreign direct investment (FDI) flows, explores impediments to pan-Asian integration, and discusses the results of a quantitative assessment of policy scenarios. The remainder of the article is arranged as follows: the second section examines regional flows of trade and FDI; the third section reviews impediments to pan-Asian integration including infrastructure, FTAs, and trade barriers and regulations; the fourth section assesses various pan-Asian integration scenarios; conclusions are drawn in the fifth section.

Regional Patterns of Trade, FDI and FTAs

A Shift in Regional Integration Priorities

Two distinct periods can be identified in South Asia–East Asia economic integration: (a) an era of limited regional integration from about 1945 until the late 1980s and (b) an era of intensifying efforts at regional integration from 1990 until the present.

Before 1990, the South and East Asian economies were relatively isolated from one another in terms of economic relations (Rana & Dowling, 2009). There was limited bilateral trade and investment flows in goods or services. There was also little talk in policy circles of pan-Asian integration using active regional integration policies. The only FTA that covered the two sub-regions was the Asia-Pacific Trade Agreement (APTA). The relative isolation between the two sub-regions before 1990 stems from a lack of political signals to foster South Asia–East Asia integration, barriers to regional trade and investment, poor regional connectivity, and cultural and linguistic barriers.

After the Second World War, South and East Asia viewed the benefits of globalization differently and followed different development strategies. Following independence from British rule in 1947, India and Pakistan adopted import-substituting industrialization strategies with high import tariffs, licensing to control entry into industries and other forms of state intervention. The private sector and exports in India and Pakistan were shackled by an anti-export bias in the trade regime.

Influenced by prevailing anti-globalization economic philosophy, the smaller South Asian economies, to varying degrees, also adopted a similar development strategy. Growth and trade in inward-oriented South Asia thus largely stagnated.

Meanwhile, after an initial import substitution period, East Asian economies (initially Korea and Taipei, China and then ASEAN) switched to outward-oriented development strategies in the 1960s and 1970s. New emphasis was given to liberalizing trade, attracting export-oriented FDI via export processing zones, and using the market mechanism for resource allocation (World Bank, 1993). By embracing globalization, East Asia rapidly industrialized and emerged as one of the world's most prosperous regions with a notable middle class as a source of final demand.

The period after 1990 to the present has been marked by intensifying efforts at regional integration between South and East Asia. Several factors explain the shift in regional integration priorities (Dasgupta et al., 2012; Francois et al., 2009a).

First, South Asian economies have adopted more market-friendly trade and investment regimes through a gradual implementation of economic reforms. Sri Lanka was the earliest South Asian economy to start a reform process in 1977. India initiated partial reforms in the 1980s and major reforms in the post-1991 period. The other South Asian economies initiated reforms only in the 1980s and 1990s.

Second, financial crises have encouraged industrial and economic restructuring in Asia. In the decade since the Asian financial crisis of 1997/98, East Asia re-emerged into the global economy with high growth, impressive flows of export-oriented FDI and localization of production networks geared towards regional markets. Following the global financial crisis of 2008, East and South Asian economies have increasingly rebalanced trade and FDI towards growth in faster-recovering regional economies and away from slower-recovering industrial economies. The giant dynamic economies of the People's Republic of China (PRC) and India have increased their economic relations with each other and acted as growth poles in their respective sub-regions.

Third, transport, communications, and logistics costs in Asia have fallen significantly amid technological progress and productivity gains. These factors have helped spur the fragmentation of manufacturing throughout Asia through global production networks and supply chains.

Fourth, FTAs involving the two sub-regions have spread to liberalize intra-Asian trade. These agreements are partly a result of India's Look East Policy as well as increasing recognition of the business opportunities from a relatively large South Asian market.

Regional Trade Patterns

Table 1 shows, South Asian exports to East Asia (in US dollars terms) grew rapidly at 13.2 per cent per year between 1990 and 2013, while imports from East Asia grew at 13.7 per cent. The value of total trade between South and East Asia

Table 1. Growth in South Asia's Trade with East Asia, 1990–2013

	Value in 2013	Annual Average Growth (%)	East Asia Share of Total (%)	
	US $ Millions	1990–2013	1990	2013
Exports				
South Asia	67,914	13.2	14.5	17.9
India	60,477	14.7	14.6	19.4
Pakistan	4,665	7.0	17.6	17.6
Bangladesh	1,783	11.2	9.3	6.5
Sri Lanka	843	6.8	9.9	8.0
Nepal	60	6.6	6.6	7.6
Maldives	75	7.0	30.1	32.3
Afghanistan	12	6.7	2.0	2.0
Imports				
South Asia	167,327	13.7	22.8	27.9
India	116,697	16.1	15.8	25.0
Pakistan	20,411	10.5	27.6	37.9
Bangladesh	17,578	12.0	35.5	44.5
Sri Lanka	8,514	10.1	35.2	39.8
Nepal	2,720	10.0	51.5	39.1
Maldives	567	8.0	70.1	40.2
Afghanistan	839	4.7	60.4	10.1

Source: International Monetary Fund Direction of Trade Statistics.
Notes: No data for Bhutan; East Asia refers to the 10 ASEAN member states, the People's Republic of China, Japan and Korea.

amounted to US$235.2 billion in 2013 (up from US$12.7 billion in 1990). India (which makes up 75.3 per cent of South Asia's trade with East Asia) saw double-digit growth in trade with East Asia. Bangladesh, Pakistan and Sri Lanka have also experienced growth in imports with East Asia but exports have lagged. The region's least developed countries (Afghanistan, the Maldives and Nepal) are at the early stages of trade with East Asia.

The share of South Asia's exports to East Asia increased from 14.5 per cent to 17.9 per cent between 1990 and 2013 and the share of imports from 22.5 per cent to 27.9 per cent (see Table 1). Underlying this shift toward East Asia is a realignment of India toward East Asia, which accounts for one-fifth of India's exports and a quarter of its imports (2013). Similarly Pakistan has also had a shift in its trade with East Asia. However, the rest of South Asia shows varying degrees of trade orientation toward East Asia. India's experience suggests that trade with East Asia offers South Asia a potentially dramatic enlargement of its

economic horizons, making available a far greater regional market with which it can integrate.

A shift is also visible within the destination of South Asia's trade with East Asia. Reflecting global trends, Japan has declined in importance while the PRC, Korea and ASEAN economies have become more important. The share of South Asia's exports to Japan fell from 57.8 per cent to 12.0 per cent between 1990 and 2013. Meanwhile the share of the PRC rose from 3.0 per cent to 26.6 per cent, Singapore from 13.4 per cent to 20.4 per cent, Indonesia from 3.8 per cent to 8.1 per cent, and Viet Nam from 0.5 per cent to 8.2 per cent.

The commodity composition of trade between South and East Asian economies tends to reflect inter-country differences in comparative advantages[3] (natural resources, capital, labour and technology) and levels of economic development. With an abundance of natural resources and labour, South Asia's exports to East Asia are weighted toward such products. Meanwhile, South Asia's imports from East Asia mainly consist of finished and high-technology goods reflecting an abundance of capital and technology. To illustrate this pattern of trade, Table 2 provides the leading items in India's trade with East Asia since 1991. India's main exports to East Asia include natural resource-intensive products (mineral fuels, pearls, stones and iron ore), cotton, fish, non-ferrous metals and ores, granite, leather and oil cake, as well as some skill and technology-intensive goods (chemicals, plastics, ships and machinery). In contrast, East

Table 2. India's Top 10 Traded Commodities with East Asia (Percentage Share of Total Exports and Total Imports)

Commodity Code	Commodity Description	2000	2012
Share of total exports			
27	Mineral fuels, mineral oils and products of their distillation	0.0	8.1
71	Natural or cultured pearls, precious or semi-precious stones, precious metals	17.5	6.8
52	Cotton	4.6	2.5
29	Organic chemicals	1.0	2.1
26	Ores, slag, and ash	8.0	1.7
89	Ships, boats, and floating structures	0.0	1.3
74	Copper and articles thereof	0.1	1.2
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	0.1	1.2
72	Iron and steel	0.1	1.0
10	Cereals	0.1	1.0

(Table 2 Continued)

(Table 2 Continued)

Commodity Code	Commodity Description	2000	2012
Share of total imports			
85	Electrical machinery and equipment and parts thereof	10.6	15.8
84	Nuclear reactors, boilers, machinery and mechanical appliances	13.4	15.0
27	Mineral fuels, mineral oils and products of their distillation	5.7	9.5
71	Natural or cultured pearls, precious or semi-precious stones, precious metals	0.5	6.8
29	Organic chemicals	3.9	6.3
15	Animal or vegetable fats and oils	4.5	6.2
72	Iron and steel	6.8	4.1
39	Plastics and articles thereof	3.7	3.1
89	Ships, boats and floating structures	2.7	3.0
87	Vehicles other than railway or tramway rolling-stock	2.2	6.4

Source: United Nations Comtrade Database.

Asia's leading exports to South Asia feature products such as computers and integrated circuits; TV, radio and telecommunications equipment; motor vehicles and motor vehicle parts; chemicals and fuels. Where there is two-way trade in the same industry, East Asian exports tend to be at a higher level of processing. For the steel industry, India's leading exports to East Asia include ferro-alloys, pig iron and rolled steel; East Asia's leading exports to South Asia include rolled steel of a heavier grade.

Regional FDI Patterns

Data on regional FDI flows are more limited than trade statistics. Data on greenfield investments[4] suggests that FDI flows between South and East Asia have nearly doubled from US$ 5.0 billion in 2003 to US$ 8.2 billion in 2013 but from a low base. FDI flows from less developed South Asia to more developed East Asia are lower than the flow the other way. As Table 3 shows, annual flows of FDI from South Asia to East Asia were only about US$4 billion in 2003–2013. Meanwhile, FDI flows from East Asia to South Asia were more than double at over US$10 billion.

Cumulative FDI flows from East Asia to South Asia in 2003–2013 were US$112.7 billion. In contrast to trade flows, Japan (with 36.9 per cent of cumulative FDI inflows in 2003–2013) is the leading foreign investor in South Asia. Korea (19.7 per cent) and the PRC (18.5 per cent) come next. Singapore (11.6 per cent)

Table 3. Foreign Direct Investment Flows of South Asia, 2003–2013 (US$ million)

	East Asia to South Asia			South Asia to East Asia		
	Annualized Average 2003–2013	Cumulative 2003–2013	Share (%)	Annualized Average 2003–2013	Cumulative 2003–2013	Share (%)
South Asia	10,248	112,731	100.0	4,047	44,522	100
India	8,602	94,621	83.9	4,014	44,157	99.2
Pakistan	796	8,760	7.8	15	165	0.4
Bangladesh	123	1,352	1.2	9	94	0.2
Sri Lanka	233	2,568	2.3	6	70	0.2
Maldives	132	1,452	1.3	N.A.	N.A.	N.A.
Nepal	23	258	0.2	3.3	36.5	0.1
Afghanistan	311	3,421	3.0	N.A.	N.A.	N.A.

Source: fDiMarkets. http.//www.fdimarkets.com (accessed 30 June 2014).
Notes: Figures cover only greenfield investments.
N.A.= not available.

and Malaysia (10.3 per cent) follow some way behind. Nataraja (2010) argues that Japanese inward investment to India is below potential, reflecting a hesitation among Japanese multinational corporations (MNCs) with regard to India.[5] The explanation is said to lie in constraints in India's investment climate, such as poor infrastructure, strict labour laws and cumbersome business procedures. These issues will be explored further in the third section.

Like trade, India dominates regional FDI flows accounting for 99.2 per cent of cumulative FDI flows from South Asia to East Asia in 2003–2013 and 83.9 per cent of cumulative FDI flows from East Asia to South Asia. Other South Asian economies have invested little in East Asia but have received some East Asian FDI. Pakistan notably accounts for 7.8 per cent of cumulative FDI flows from East Asia to South Asia.

Cumulative FDI inflows from East Asia to India during 2003–2013 are diversified. The largest FDI activity is automotives and parts (22.2 per cent). This is followed by metals (18.2 per cent); real estate (6.2 per cent); communications (4.0 per cent); consumer electronics (4.0 per cent); engines and turbines (4.0 per cent); industrial machinery, equipment and tools (3.9 per cent); and semiconductors (3.9 per cent). Meanwhile, India's outflows of FDI to East Asia are concentrated in resource activities (34.0 per cent in metals and 14.1 per cent in coal, oil and gas) and service activities (10.3 per cent in financial services, 8.5 per cent in software and information technology [IT] services, 2.2 per cent in transportation, and 2.2 per cent in hotels and tourism).

The leading East Asian investor is Japan (with 35 per cent of cumulative FDI into India during 2003–2013) and nearly half of this went into automotive and parts. Japanese FDI also went into machinery and tools, electronics, chemicals,

rubber. Korea (19 per cent of cumulative FDI into India) comes next and one-third of Korean FDI went into metals and another one-fifth into automotives and parts. The PRC is third (13 per cent of cumulative FDI) and just under half of this is in metals and another one-fifth is in engines and turbines. Singapore is fourth (with 11 per cent of cumulative FDI) and one third of this is in real estate and another quarter is in semiconductors.

Key Impediments to Pan-Asian Integration

While the pace of South Asia–East Asia economic integration has picked up since 1990, many impediments at regional and national levels remain, which can hamper the process. Four key impediments are (*a*) gaps in cross-border infrastructure; (*b*) a risk of insufficient depth and business use of FTAs; (*c*) trade barriers and cumbersome business procedures; and (*d*) barriers to services trade.

Gaps in Infrastructure

Asia's trade performance and its ability to attract FDI depend fundamentally on efficient, reliable, and seamless infrastructure (ADB & ADBI, 2009). The spread of global supply chains in East Asia means that manufacturing activities have been dispersed over geographical space connected by trade in parts, components, and services. India has gradually been incorporated into supply chains through FDI from Japan, Korea and ASEAN economies. Investment in cross-border infrastructure, multimodal transport systems and logistics are critical to facilitate South Asia–East Asia supply chain integration.

Detailed technical studies of infrastructure connectivity assess different transport options to efficiently and seamlessly integrate South and East Asia trade (ADB & ADBI, 2013; Arnold, 2009). These studies have also identified several missing links and bottlenecks—particularly in sea and land transport—in connectivity between South and East Asia. They find that the dominant mode for freight transport between South and East Asia remains ocean transport and this situation is expected to continue for the foreseeable future. International shipping lines serving the South Asia–East Asia region operate on the equatorial route connecting East Asia and the Persian Gulf and the Mediterranean. The introduction of larger container ships and expansion of feeder services have supported trade growth. However, problems have been identified in the facilities and operational efficiency of public ports (such as Chittagong Port in Bangladesh, Kolkata Port in India and Yangon Port in Myanmar) and links between ports and road networks.[6]

Furthermore, it is suggested that the recent opening up of Myanmar through political and economic reforms means that land transport (both road and rail) will have an increasing role in bilateral trade within Asia, but major improvements are

needed (ADB & ADBI, 2013). New land corridors between India and the People's Republic of China (PRC) through Bhutan and Nepal are required, necessitating large investments. For instance, a minimum investment of US$18 billion is needed for road creation and improvement totalling 26,000 kilometres of roads to complete the Asian Highway project. Land access to ports is also important for landlocked countries. With respect to the intra-regional rail network, the Trans-Asian Railway (TAR) network includes about 10,500 kilometres of missing links that need to be constructed to provide for an unbroken TAR network. Moreover, the incompatibility of gauges (track widths) in India, Bangladesh, Thailand, and Myanmar means that trans-shipment will be required even after through rail links are developed. Air transport is growing in importance as the value of commodities traded between the two regions increases; however, the growth in air freight has lagged behind that of ocean transport and is likely to continue to do so.

Inter-country comparisons of the quality of infrastructure are difficult due to measurement problems, statistical gaps, and the inherently subjective nature of such evaluations (ADB & ADBI, 2009). Table 4 provides one such evaluation

Table 4. Quality of Infrastructure, 2013

	Quality of Overall Infrastructure	Road	Railroad	Port	Air Transport	Electricity Supply
India	3.9	3.6	4.8	4.2	4.8	3.2
Pakistan	3.3	4.0	2.5	4.5	3.2	2.0
Bangladesh	2.8	2.8	2.4	3.5	3.2	2.2
Sri Lanka	4.8	4.7	3.6	4.2	4.8	5.0
Nepal	2.9	2.7	1.1	2.7	3.0	1.6
Bhutan	4.9	4.3	N.A.	2.2	3.5	5.9
Memo Items						
PRC	4.3	4.5	4.7	4.5	4.5	5.7
Korea, Rep. of	5.6	5.8	5.7	5.5	5.8	4.3
Indonesia	4.0	3.7	3.5	3.9	4.5	5.2
Thailand	4.5	4.9	2.6	4.5	5.5	5.2
Malaysia	5.5	5.4	4.8	5.4	5.8	5.8
Philippines	3.7	3.6	2.1	3.4	3.5	4.0
Vietnam	3.4	3.1	3.0	3.7	4.0	4.0

Source: Klaus et al. (2013).

Notes: 1 = worst possible situation; 7 = best situation.
Quality of Infrastructure is one of the indicators used to measure global competitiveness in an annual survey conducted by the World Economic Forum. The scores are based on opinions of business leaders in a survey conducted in 148 economies.
N.A. = not available, PRC = People's Republic of China.

based on a survey of global business leaders' perceptions and available hard data indicators on ports, roads, railways and air transport. A value of 7 in the scoring system used shows the best possible situation and 1 the worst. The data suggest that the quality of infrastructure in South Asian economies typically lags behind East Asian economies. In terms of the quality of overall infrastructure, South Asia's largest economies fare poorly: India has a value of 3.9, Pakistan 3.3 and Bangladesh 2.8. Sri Lanka (4.8) and Bhutan (4.9) are exceptions in South Asia. By comparison, Korea has a value of 5.6, Malaysia 5.5 and the PRC 4.3. Interestingly, the Philippines and Viet Nam underperform in East Asia.

Thus, while improvements have occurred in regional infrastructure, South Asia in particular has a large unfinished agenda to improve the quantity and quality of its infrastructure.

A Risk of Insufficient Depth and Business Use of Free Trade Agreements

Preferential liberalization is a relatively recent phenomena in South Asia–East Asia economic relations (Asher & Sen, 2008; Scollay & Pelkmans-Balaoing, 2009). By December 2013, nine FTAs were in effect between South and East Asian countries, with eight taking effect since 2004. More FTAs are being negotiated. Furthermore, these FTAs have only involved South Asia's two largest economies, India and Pakistan. While it is early days in South Asia–East Asia FTAs, two concerns arise.

First, the agreements in effect vary in their provisions to reduce trade barriers. Table 5 summarizes our assessment of liberalization in major South Asia–East Asia FTAs in the areas of goods, services, and regulatory barriers.[7] Our results suggest

Table 5. Scope and Depth of South Asia–East Asia Free Trade Agreements

	Goods Liberalization	Services Coverage	Deep Integration
India–Japan FTA (2011)	Relatively fast	Some	Deep
India–Malaysia FTA (2011)	Relatively fast	Some	Moderate
ASEAN–India FTA (2010)	Gradual	Excluded	Shallow
India–Korea FTA (2010)	Gradual	Comprehensive	Moderate
India–Singapore FTA (2005)	Relatively Fast	Comprehensive	Limited
Pakistan–Malaysia FTA (2008)	Limited	Some	Limited
Pakistan–PRC FTA (2007)	Gradual	Some	Limited
Asia-Pacific Trade Agreement (1976)	Limited	Excluded	Shallow

Source: Author's assessment based on the methodology outlined in Wignaraja et al. (2013).
Notes: ASEAN = Association of Southeast Asian Nations, FTA = free trade agreement, PRC = People's Republic of China.

that South Asia–East Asia FTAs fall into two types: (*a*) limited agreements that deal mainly with barriers to goods trade; and (*b*) agreements that extend liberalization beyond goods trade to tackle services and regulatory barriers. The APTA, the PRC–Pakistan FTA and the Pakistan–Malaysia FTA are mainly goods agreements. The remaining FTAs listed in Table 5 are somewhat more comprehensive. The ASEAN–India FTA initially covered goods liberalization but has recently expanded to cover services and investment. The India–Singapore FTA excludes agriculture and transit but has reasonable coverage of services and cooperation enhancement provisions. The India–Korea FTA also has reasonable coverage of services and moderate coverage of regulatory barriers while the India–Japan FTA covers some services and has wider coverage of regulatory barriers. In general, there seems room for improvement in the coverage of services and regulatory issues in South Asia–East Asia FTAs.

Second, use of tariff preferences in South Asia–East Asia FTAs differs between agreements. We were able to obtain some information on export value using FTA preferences from national sources in Thailand, Malaysia, and Vietnam for a few FTAs (Thailand–India FTA, ASEAN–India FTA and Pakistan–Malaysia FTA). The Thai data obtained from the Ministry of Commerce of Thailand show an increase in the combined utilization rate of the Thailand–India FTA and the ASEAN–India FTA from 17.6 per cent to 36.6 per cent between 2005 and 2011. The Vietnam data obtained from the Ministry of Industry and Trade of Vietnam also indicate an increase in utilization of the ASEAN–India FTA between 2010 and 2011, but its 2011 figure (7.4 per cent) is lower than that of Thailand. However, the Malaysian data gathered from the Ministry of International Trade and Industry of Malaysia indicates a significant increase in utilization of the Pakistan–Malaysia FTA from 1.4 per cent to 74.3 per cent between 2006 and 2010.

Thus, the evolving trend toward South Asia–East Asia FTAs carries two risks: a tendency toward insufficient liberalization and depth of agreements as well as suboptimal preference use. Asia should pursue a geographically broad scheme, instead of an expanding web of bilateral and sub-regional agreements. Against slow progress in the WTO Doha Round trade talks, a pan-Asian FTA can promote continuing liberalization, induce structural reforms, and widen market access across the region. With a view to making the proliferation of FTAs between South and East Asia ‘stepping stones’ rather than stumbling blocks to multilateralism and to reduce inefficiencies due to overlapping rules of origin and others, policy makers may wish to adopt the concept of ‘open regionalism’ and broaden FTAs by creating as large and as wide a market as possible.

In this vein, one major pan-Asian FTA under negotiation is noteworthy. In November 2012, ASEAN members and their FTA partners (including India, Japan, the PRC, Korea, Australia and New Zealand) agreed to negotiate an RCEP that would result in the world’s largest trading bloc covering 40 per cent of world trade. The first round of RCEP negotiations took place in middle of 2013 with the ambitious goal of finishing in 2015. India is the only South Asian economy to join the negotiations thus far. This will give Indian business a greater opportunity to

access markets in East Asia and to integrate into regional production networks. None of the other South Asian economies has expressed a desire to join the RCEP, but this may change if they become concerned about being left out of the large regional integration group.

Trade Barriers and Cumbersome Business Procedures

Although tariff protection has been falling in South Asia, overall levels are typically higher than in East Asia. Table 6 shows import tariffs for agriculture and manufactures for 1990, 2000 and 2012 along with information on nontariff measures (NTMs)

Table 6. Ease of Trading Across Borders and Doing Business

	Simple Average MFN Tariffs Agricultural Materials (%)		Simple Average MFN Tariffs Manufactures (%)		NTMs Implemented	Ease of Doing Business Rank (out of 189 Economies)
	1990	2012	1990	2012	2009–2013	2013
India	77	28.9	84.1	9.2	206	134
Pakistan	45.5	14.6	n.a.	14.3	16	110
Bangladesh	99.5	17.2	123.1	14.5	1	130
Sri Lanka	38.1	19.1	27	7.4	10	85
Maldives	18.2	17.9	n.a.	20.7	1	95
Nepal	9.4	11.3	18.9	12.2	2	105
Afghanistan	n.a.	6.3	n.a.	5.9	1	164
Bhutan	14.3	37.2	15.5	18.3	0	141
Memo Items						
PRC	42.5	13.6	43.9	9.2	98	96
Indonesia	20.1	5	19.3	7.3	68	7
Republic of Korea	11.4	26.3	7.8	7.4	19	120
Malaysia	12.7	10.1	9.4	6.1	9	18
Thailand	40.5	18.6	41.7	8.7	11	6
Philippines	23.1	6.8	20.9	5.1	5	108
Vietnam	17.7	15.4	14.3	9.1	21	99

Source: World Bank World Integrated Trade Solutions (http://wits.worldbank.org/wits/) for MFN tariffs; Global Trade Alert Database (http://www.globaltradealert.org/site-statistics) for nontariff measures; and World Bank Doing Business Report 2014, for ease of doing business rank.

Notes: Where data are not available the most recent year is used.
MFN = most favoured nation, NTM = nontariff measure, PRC = People's Republic of China.

implemented during the period 2009–2013 and the World Bank's Ease of Doing Business Rank. The average agricultural tariff in India is 28.9 per cent (2012), while for the PRC (reflecting a decade of accession to the WTO) it is 13.6 per cent. Interestingly, average manufacturing tariffs for the PRC and India are the same at 9.2 per cent (2012), with India showing a large reduction between 2000 and 2012. Furthermore, while tariffs seem low in many East Asian countries, NTMs can be reduced. During the post-global financial crisis era, the numbers of NTMs implemented were 98 for the PRC, 68 for Indonesia, and 19 for Korea. These figures compare with 206 for India, 16 for Pakistan and 10 for Sri Lanka.

NTMs are policy measures, other than customs tariffs, that can potentially have an effect on trade costs by changing prices, quantity traded, or a combination of both. The above data cover 22 types of NTMs including: bail outs/state aid measures; trade defence measures (antidumping—AD, countervailing duties—CVD, safeguards); non-tariff barriers (not otherwise specified); export taxes or restrictions; investment measures; migration measures; export subsidies; public procurement; import bans; trade finance; import subsidies; quotas (including tariff rate quotas); state-controlled companies; competitive devaluation; state trading enterprises; sub-national government measures; sanitary and phytosantiary measures; intellectual property protection; consumption subsidies; local content requirements; other service sector measures; and technical barriers to trade.

According to the World Bank Ease of Doing Business indicators, East Asia is typically a more open destination than South Asia. As the earliest adopter of economic reforms, in South Asia, Sri Lanka has the highest rank (85th) within the subregion. Maldives (95th) comes next. However, the large South Asian economies (Bangladesh, India and Pakistan) achieve rankings well in excess of 100. Meanwhile, Malaysia is ranked 6th, Korea 7th and Thailand 18th. Hence, East Asia serves as a more preferred destination for FDI than South Asia. East Asia also benefits more from the potential for regional integration of industries through a dense network of global production networks and supply chains, as well as large domestic markets.

Efforts at trade liberalization and streamlining business procedures in South Asia need to be embedded in a wider program of so-called second generation economic reforms to support inclusive growth.[8] Important measures would include fiscal consolidation, reform of state-owned enterprises, improvement of domestic competition policy, reforms to the civil service and delivery of public goods, and reforms to institutions that create human capital (such as health and education).

Potential for Services Trade and Barriers

Studies suggest that services have been on the rise in output in Asia. From 45 per cent of the average share in 1990, the services sector made up 48.5 per cent of GDP in 2010 (Noland et al., 2013). In newly-industrializing economies of East Asia such as Korea; Hong Kong, China; and Taipei, China, the services sector has GDP shares of 60–90 per cent. In ASEAN economies (with the exception of Singapore and the

Philippines), the sector makes up less than 50 per cent of GDP. South Asian economies have uniformly rapidly growing services sectors particularly India, Sri Lanka, and Nepal where shares have risen by 15–20 percentage points, respectively.

The services sector is also an important contributor to trade in South and East Asia. The average share of services trade in GDP in South Asian economies was 11 per cent in 2012 compared with 22 per cent in East Asia. India and Sri Lanka are outliers in South Asia, with shares of 15 per cent and 14 per cent, respectively. Pakistan (7 per cent), Bangladesh (7 per cent), and Nepal (10 per cent) have quite low shares. East Asia has an even greater diversity in services trade between high and low shares: Singapore (87 per cent), Thailand (28 per cent), Malaysia (26 per cent), Indonesia (7 per cent) and the PRC (6 per cent).

Overall estimates of the magnitude of trade in services between South and East Asia are not available, but there seems to be growth in selected sectors in selected countries (Findlay et al., 2009). India's IT services exports grew at 14.5 per cent over the 2011–2012 period and were valued at US$ 51.8 billion (Reserve Bank of India, 2013). There is considerable potential for further expansion as top Indian IT firms are currently attempting to diversify their markets using various strategies, such as setting up offices in the PRC to serve the local market and to attract the Japanese outsourcing business by employing workers from the PRC and Japan to overcome the language barriers.

Contractual construction and labour services are the PRC's major service sectors, especially in Asia (Findlay et al., 2009). In South Asia, Pakistan is one of the most important markets for contractual construction service exports from the PRC. The PRC also has some history of construction and labour exports to Sri Lanka and Bangladesh. Meanwhile, South Asian and ASEAN countries export labour services, and remittances from these economies are also increasing. Japan and Korea may provide selective opportunities for migration as their respective workforces age.

However, there is evidence of important impediments to trade and investment inhibiting trade in services between the regions. Table 7 provides a services trade restrictiveness index from the World Bank for 2012. This attempts to capture the policies and regulations that discriminate against foreign services or foreign service providers as well as certain key aspects of the overall regulatory environment that have a notable impact on trade in services. A high score suggests greater restrictiveness. Measuring services trade restrictiveness is a difficult undertaking beset by data gaps and subjective judgements. Bearing this qualification mind, the data suggest that India has greater restrictions on trade in services than large East Asian economies such as the PRC, Japan and Korea. Trade in services restrictions in Bangladesh, Nepal and Sri Lanka are slightly lower (or comparable) with levels in the Philippines, Indonesia, Thailand and Malaysia. There are concerns particularly in South Asia about the large costs of adjustment to liberalization of services trade on unemployment, poverty and loss of universal access to basic services (Kelegama, 2009). Some South Asian countries have thus adopted a cautious approach to services trade liberalization.

Table 7. Services Trade Restrictiveness Index, 2012

South Asia	
India	65.7
Bangladesh	44.2
Nepal	42.9
Sri Lanka	38.2
Pakistan	28.3
East Asia	
Philippines	53.5
Indonesia	50.0
Thailand	48.0
Malaysia	46.1
Vietnam	41.5
People's Republic of China	36.6
Cambodia	23.7
Japan	23.4
Korea	23.1
Others	
United States	17.7
United Kingdom	14.3

Source: World Bank Services Trade Restrictions Database (2012).

Note: The World Bank's Services Trade Restrictions Database collects information on services trade policy across 103 countries, five sectors (telecommunications, finance, transportation, retail and professional services), and the key modes of service supply. A high score suggests greater restrictiveness.

Enhancing services trade between South and East Asia will be a challenging process. First, a major cooperative effort at national and regional levels is needed especially in South Asia to improve the data on the services sector and services trade (Kelegama, 2009). Second, it will involve creating competitive services markets through a combination of policy reforms, productivity improvements, and investments in infrastructure and human capital (Noland et al., 2013).

Quantifying the Benefits of Pan-Asian Integration

Multi-country computable general equilibrium (CGE) models can quantitatively assess the benefits and costs of regional integration schemes, including those involving South Asian and East Asian economies. The aim of a CGE modelling

approach is to incorporate the complex relations between prices, markets and income. A multi-country model permits taking account of the effects of a changing world economic environment and feedback linked to bilateral trade liberalization.

A few studies have analyzed the impact of policy scenarios involving South Asian FTAs as well as India–East Asia FTAs.[9] The policy scenarios in early CGE studies narrowed the focus on FTAs involving only goods, while more recent studies have broadened the FTA coverage to other aspects of trade such as services and trade costs. There is limited work on a South Asia–East Asia FTA. Accordingly, the results of a comprehensive CGE exercise by Francois and Wignaraja (2009) on various FTA scenarios involving South Asian and East Asian economies are reported here.[10]

Some broad welfare effects from the following FTA scenarios are examined:

1. An ASEAN–India FTA: free trade among ASEAN members and India. This scenario shows the impact of India's Look East Policy with ASEAN. A trade in goods agreement is in effect between India and ASEAN, while agreements on services and investment have been concluded.
2. An ASEAN+3–India FTA: scenario 1 plus the PRC, Japan, Korea. This scenario provides an extension of India's Look East Policy to the whole of East Asia. This includes all the major Asian players in the RCEP negotiations.
3. An ASEAN+3–South Asia FTA: scenario 2 plus all South Asian countries.
4. An EU–India FTA: free trade among the EU members and India. This scenario shows the impact of a comprehensive EU–India FTA covering goods, services, and trade cost reduction. FTA negotiations between India and the EU have been ongoing since 2007.
5. A US–India FTA: free trade between the US and India. This scenario represents an FTA that is not even under official study by either India or the US.

The scenarios illustrate several important FTA possibilities for South Asia. Figure 1 shows the estimated impacts on India's national income of the FTA scenarios 1–5. The model's baseline is 2017 and the simulations show changes from this baseline. Interestingly, India gains more in terms of economic welfare from pursuing large integration schemes with Asian economies than those with either the EU or the US. In this vein, India reaps significant welfare gains from scenarios 2 and 3 by involving dynamic East Asian economies (ASEAN, the PRC, Japan and Korea) in FTA arrangements. Nonetheless, an ASEAN+3–South Asia FTA scenario offers larger gains to India than the ASEAN+3–India FTA scenario.[11] This suggests that India gains more by including the rest of South Asia in a trading arrangement with East Asia than going it alone with East Asia. Among the other three scenarios shown in Figure 1, the EU–India FTA scenario

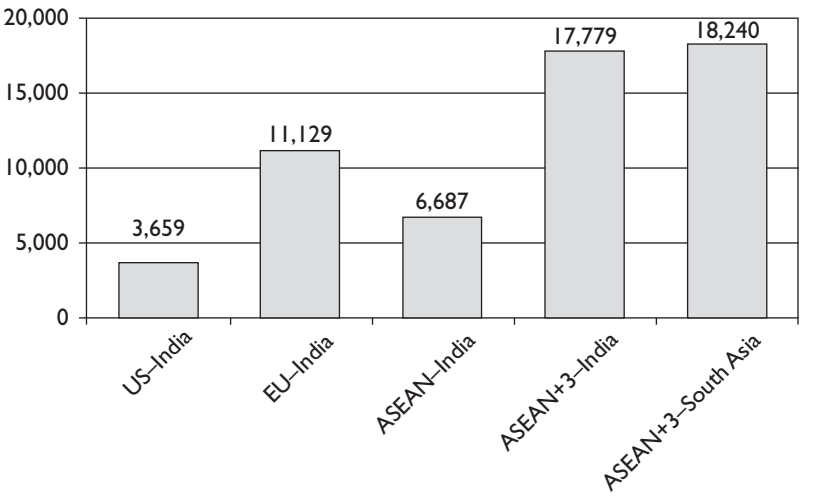

Figure 1. Welfare Impacts on India of Different Free Trade Agreement Scenarios ($ Million Change Compared to 2017 Baseline, at Constant 2001 Dollars)

Source: Estimates based on computable general equilibrium model in Francois and Wignaraja (2009).

Notes: ASEAN = Association of Southeast Asian Nations, ASEAN+3 = ASEAN, plus the People's Republic of China, Japan and Korea, EU = European Union, US = United States.

offers the next largest gains for India, followed by an ASEAN–India FTA and a US–India FTA.

Table 8 shows the detailed results for scenarios 1–3. The broadest scenario 3, which includes ASEAN+3 countries and all the South Asian countries, sees income gains for members of the FTA of about 2.0 per cent of base income for South Asia and 2.4 per cent for ASEAN+3 countries. In terms of changes in base income, there are substantial income gains for India and other South Asian countries. Pakistan, however, experiences smaller income gains (0.2 per cent). There are minimal negative effects for outsiders to the broad ASEAN+3–South Asia FTA. The EU sees a small gain while the US and the rest of the world see small losses.

Comparing scenarios 1 (an ASEAN–India FTA)[12] and 2 (an ASEAN+3–India FTA), a consistent pattern is visible of notable gains for regional participants and minimal effects for outsiders. India's gains increase significantly from 0.83 per cent of base income to 2.23 per cent between the two scenarios due to inclusion of the large Northeast Asian neighbours into an FTA arrangement. The other South Asian countries lose by not being included in either arrangement.

The outcome of scenario 3 implicitly assumes that South Asia is internally quite well integrated. However, studies argue that the South Asia Free Trade Agreement (SAFTA) process involving the eight SAARC members has lost momentum and that South Asia remains one of the least integrated regions globally (Khan, 2012;

Table 8. National Income Effects of Alternative Free Trade Agreement Scenarios (Value and Per cent Change Compared to 2017 Baseline, at Constant 2001 Dollars)

	ASEAN–India FTA		ASEAN+3–India FTA		ASEAN+3–South Asia FTA	
	Value ($ millions)	% Change	Value ($ millions)	% Change	Value ($ millions)	% Change
South Asia	**6,466**	**0.57**	**16,199**	**1.44**	**22,423**	**1.99**
India	6,630	0.83	17,779	2.23	18,240	2.29
Pakistan	–46	–0.03	–862	–0.58	298	0.2
Bangladesh	–31	–0.03	–355	–0.31	1,874	1.66
Sri Lanka	–11	–0.04	–123	–0.4	631	2.03
Other South Asia	–75	–0.2	–240	–0.65	1,380	3.73
ASEAN+3	**5,264**	**0.05**	**240,810**	**2.38**	**243,296**	**2.4**
PRC	–882	–0.03	43,289	1.32	43,454	1.32
Japan	–664	–0.01	78,080	1.61	78,650	1.62
Republic of Korea	–396	–0.05	51,545	6.46	52,100	6.53
Cambodia	1	0.01	106	1.18	79	0.88
Indonesia	1,384	0.46	8,818	2.93	9,090	3.02
Malaysia	1,925	1.03	12,014	6.4	12,376	6.6
Philippines	392	0.33	3,521	2.93	3,495	2.91
Singapore	1,644	0.99	9,285	5.6	9,717	5.86
Thailand	1,879	0.85	28,220	12.78	28,534	12.92
Vietnam	194	0.27	5,449	7.57	5,428	7.54
European Union	1,130	0.01	9,248	0.08	10,300	0.09
United States	1,036	0.01	–3,214	–0.02	–1,924	–0.01
Rest of the World	1,008	0.01	–11,681	–0.13	–13,188	–0.14
World	**14,904**	**0.03**	**251,363**	**0.52**	**260,907**	**0.54**

Source: Estimates based on computable general equilibrium model in Francois and Wignaraja (2009).

Notes: Other South Asia refers to Afghanistan, Bhutan, the Maldives and Nepal. Other Southeast Asia refers to Brunei Darussalam, the Lao People's Democratic Republic and Myanmar. ASEAN = Association of Southeast Asian Nations, ASEAN+3 = ASEAN, plus the PRC, Japan and Korea, FTA = free trade agreement, PRC = People's Republic of China.

Weerakoon, 2010). Fears of domestic industries in smaller South Asian economies being swamped by cheap Indian imports, restrictions on India–Pakistan trade, bureaucratic inertia and security concerns explain the limited progress in South Asian integration.

Nonetheless, to illustrate potential benefits of South Asian integration, Francois and Wignaraja (2009) also report the outcome of an evolving SAFTA process

(covering goods, services and trade facilitation). This scenario seems useful as SAFTA has had a goods agreement in effect for some years and a services agreement took effect in 2012 as an expansion of SAFTA. The welfare gain from a South Asian FTA scenario (covering goods, services, and trade facilitation) amounts to about US$3.7 billion (or 0.33 per cent of South Asia's base income).[13] All South Asian economies see gains in base income but smaller economies experience particularly notable gains, which is encouraging for South Asian integration.

Conclusions

This article focused on whether South Asian economies benefit from integrating with East Asia and whether there are economic grounds for India to include its South Asian neighbours in the process. To address these questions, the article examined trade and FDI; impediments to integration; and the results of a CGE assessment of policy scenarios for regional integration.

Three important points emerge from the research.

First, there is evidence of increased economic integration between South and East Asia but the process is uneven.[14] Bilateral trade flows have grown rapidly from a small base since 1990, led by India and, to a lesser extent, Pakistan. FDI flows particularly from East Asia to South Asia have increased but levels are smaller than regional trade flows reflecting higher costs and risks of setting up overseas plants rather than trading from home. Additionally, the bulk of East Asian FDI goes to India. Little regional policy integration has occurred with only a handful of recent South Asia–East Asia FTAs focusing on India and Pakistan. Smaller South Asian economies are in the early stages of integration with East Asia—imports from East Asia have grown, but exports, FDI and FTAs have lagged.

Second, several problems hamper the development of further economic integration between South and East Asia. Key impediments include gaps in infrastructure, a risk of insufficient depth and business use of FTAs, trade barriers and cumbersome business procedures and barriers to services trade. Coherent remedies at the regional and national levels are required to tackle these issues, including investing more and improving the quality of cross-border infrastructure, developing a broad FTA covering ASEAN+3 and South Asia that is comprehensive in scope, continuing the lowering of trade protection and implementing a wider programme of domestic structural reforms, and reducing barriers to services trade and investing in human capital.

Third, the results of a CGE quantitative exercise indicate regional integration policy choices for India and the rest of South Asia. In essence, India and other South Asian economies will benefit from a broad pan-Asian FTA arrangement that involves East Asia as well as the rest of South Asia. However, if India goes on it alone in an FTA with East Asia, the rest of South Asia will experience losses and India's gains will be smaller. Hence, the simulation results suggest that a comprehensive South Asia–East Asia FTA is an optimal policy choice for South Asia and

that India has an incentive to include its neighbours in a trading arrangement with East Asia. One route would be for India to reinvigorate economic integration within South Asia by encouraging a comprehensive SAFTA (which significantly reduces trade barriers between India and Pakistan). India's South Asian neighbours should follow suit by deepening South Asian integration and actively fostering closer economic ties with East Asia.

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Notes

1. South Asia includes the eight South Asian Association for Regional Cooperation (SAARC) members (Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka). East Asia includes the 10 Association of Southeast Asian Nations (ASEAN) members, the People's Republic of China, Japan and Korea.
2. For a recent selection, see ADB and ADBI (2013), Francois et al. (2009b, 2009c), Kumar et al. (2006), and Kumar et al. (2008).
3. Analyses of revealed comparative advantages at the product level in South and East Asian trade are contained in Dasgupta et al. (2012) and Scollay and Pelkmans-Balaoing (2009). These studies conclude that South Asian countries exhibit a relatively narrow range of comparative advantages compared to East Asia.
4. fDiMarkets defines greenfield investments as cross-border investment in a new physical project or expansion of an existing investment that creates new jobs and capital investment. Joint ventures are included where they lead to a new physical operation. However, mergers and acquisitions as well as other equity investments—generally the largest element of FDI inflows—are not tracked by FDI markets. Hence, the data in Table 3 understate the magnitude of regional FDI flows.
5. Case studies of Japanese subsidiaries or joint ventures in India by Roy Choudhury (2009) suggest that in the telecommunications and pharmaceuticals sectors, India has become a potential destination for research and development activity because of its relatively cheap but highly qualified technical human resources. Furthermore, Japanese firms value trust in their partner and each of the firms that has a joint venture in India spent a long time deciding on the partnership.
6. In Chittagong Port, the size of vessels that are able to call is limited by the width and curvature of the Karnaphuli River. Rail and road traffic between Chittagong Port and Dhaka also created severe bottlenecks. Yangon Port also has several problems, including limited accessibility to large vessels, poor road conditions between the Thilawa port area and the bridge leading to Yangon, high container charges, obsolete facilities in Yangon port, frequent blackouts and insufficient generators, and lack of cargo equipment (see ADB & ADBI, 2013).
7. Goods liberalization evaluates the speed and coverage of tariff liberalization based on the criteria for FTAs in the WTO General Agreement on Tariffs and Trade. Services liberalization evaluates the number of services sectors covered based on the WTO General Agreement on Trade in Services. Coverage and liberalization in intellectual

property, investment, government procurement, trade facilitation, and competition were based using criteria for individual issues such as adherence to international agreements such as the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights and the Government Procurement Agreement.

8. For assessments of reform and the case for second generation reforms in South Asia, see Dee (2012) and Wignaraja (2011, 2012).
9. For CGE studies of South Asian FTAs, including the South Asia Free Trade Agreement, see ADB and UNCTAD (2008), Bandara and Yu (2003) and Siriwardana (2003). Meanwhile, Cheong and Tongzon (2013), Kawai and Wignaraja (2013) and Mohanty and Pohit (2008) examine FTA scenarios involving India, East Asian economies, Australia and New Zealand.
10. Four features of the CGE model used in Francois and Wignaraja (2009) are noteworthy: (*a*) strong microeconomic foundations and detailed interactions among industries, consumers, and governments across the global economy; (*b*) medium- to long-run investment effects by allowing for trade to affect capital stocks through investment activities; (*c*) use of the Global Trade Analysis Project database through to 2017, which projects trade and production patterns to represent a post-Uruguay Round world; and (*d*) a stylized FTA that includes goods, services, and trade cost reduction.
11. The ASEAN+3–South Asia FTA scenario, an illustrative example of a broad region-wide scenario, offers larger gains to India's income ($18.2 billion, measured in constant 2001 prices) than the ASEAN+3–India FTA scenario ($17.8 billion). These are conservative estimates of the minimum gains that would arise from such an integration scenario.
12. Francis (2011) analyzes tariff reduction commitments under the ASEAN–India FTA and the extent of potential market access that ASEAN countries will gain in India's agriculture and non-agriculture sectors. She points to potential gains and losses from import liberalization under the FTA. Heavy manufacturing branches (transport equipment, machinery, chemicals, and iron and steel) are likely to gain as the entry of MNCs will facilitate integration into Asian production networks. However, semi-processed and processed agricultural products, and light manufacturing are likely to be adversely affected by increased market access for cheaper ASEAN imports.
13. The economic effects of a South Asian FTA reported in Francois and Wignaraja (2009) resemble Siriwardana (2003) who reports gains for South Asia of about US$4 billion. Other studies, which look mostly at goods trade liberalization, suggest gains of less than US$1 billion from a South Asian FTA. Accordingly, Bandara and Yu (2003) suggest gains for South Asia of US$771.4 million and ADB and UNCTAD (2008) of US$858.3 million. Reflecting its economic size in South Asia, India sees gains of US$3.1 billion in Siriwardana (2003), US$756.2 million in Bandara and Yu (2003) and US$366.0 million in ADB and UNCTAD (2008).
14. With the benefit of a few additional years of data, our conclusion about the pace of South Asia–East Asia economic integration is somewhat more nuanced and qualified than earlier studies (for example, Asher & Sen, 2008).

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