Economic Growth Centre
Working Paper Series

Linking South Asia with East Asia: Trends, Potential, and Policies

by

Pradumna B. RANA

Economic Growth Centre
Division of Economics
School of Humanities and Social Sciences
Nanyang Technological University
Nanyang Avenue
SINGAPORE 639798

Website: http://www.ntu.edu.sg/hss/egc/

Working Paper No: 2008/04

Copies of the working papers are available from the World Wide Web at:

Website: http://www.ntu.edu.sg/hss/egc/

Linking South Asia with East Asia: Trends, Potential, and Policies*

Pradumna B. Rana
Senior Fellow
Division of Economics
Nanyang Technological University
Singapore

June 2008

Abstract
Recently, there has been growing interest in the evolving economic relationships between South Asia and East Asia. What could be the implications of the re-emergence of the two giant economies or hegemons – India and China - on the region and globally? Could these relationships be the second phase of Pan-Asian integration? Will Asia be as well-integrated as it was during the pre-colonial period? This paper finds that the level of economic integration between South Asia and East Asia, although increasing since 1990, started to surge after 2000, albeit from a low base, mainly because of growing interdependence between India and China. The level of integration is, however, low in relative terms. By calculating the usual indices, the paper finds that, although there are overlaps, there are also significant amounts of complementarities between the two regions on goods and service trade. The level of economic integration between the two regions is, therefore, bound to increase. The paper concludes by identifying a set of measures to enhance policy-led integration between the two regions including those seeking to reduce transportation costs.

* An earlier version of this paper was presented at a Seminar organized by the Economic Growth Center, NTU on 9 April, 2008. The author is grateful to the participants for useful comments.

Linking South Asia with East Asia: Trends, Potential, and Policies

I. Introduction

Recently, for various reasons, there has been growing interest in the evolving economic relationships between South Asia[1] and East Asia[2]. First, two of the most dynamic countries in the world, namely, China and India, are in the region and the evolution of these giant economies together with growing economic interrelations between the two could have important implications for other countries in the region and the global economy. Second, with the surge in regionalism in post-crisis East Asia, a question that is frequently being asked is, will growing economic relations between South Asia and East Asia be the second phase and eventually lead to an integrated Pan-Asia similar to the integration achieved in Europe, sometime in the future? Third, during the pre-colonial period, Asia not only dominated the global economy but was one of the most integrated regions of the world, will this happen once again?

The objectives of this paper are threefold: to review trends in economic integration between South Asia and East Asia, highlight the potential for increased integration in the future, and recommend policies to complement market-led integration between the two regions. While there is growing interest on South Asia–East Asia economic relations, most studies on regionalism in Asia focus on either South Asia or East Asia separately. Studies on the implications of economic cooperation between the two regions are few—the only exceptions are a number of studies on BIMSTEC (e.g., ADB 2005)—and these focus mainly on India's economic relations with the China, ASEAN, or ASEAN+3 (Asher and Sen 2005; Kumar, Sen, and Asher 2006; Mohanty, Pohit, and Roy 2004). An exception is Chandra and Kumar (2008). It is true, no doubt, that India accounts for about 80% of South Asia's gross national product (GNP) and has been the most active in pursuing enhanced economic relations with East Asia under its so-called "Look East" policy. However, other countries in South Asia such as Pakistan and Sri Lanka are also now initiating FTA discussions with various East Asian countries, and Bangladesh, Bhutan, Nepal and Sri Lanka are members of BIMSTEC.

The rest of the paper is organized as follows. Section II, reviews the evolution of political and economic relations between South Asia and East Asia from a historical perspective. Section III analyses trends in economic integration between the two regions using various

[1] South Asia to the seven members of the South Asia Association for Regional Cooperation (except Afghanistan).
[2] Refers to the 13 member countries of the ASEAN+3 group.

quantitative measures. Section IV, assesses the potential for integration between South Asia and East Asia through the usual measures of economic complementarities between the two regions for both goods as well as service trade. Section V reviews ongoing policy efforts to promote integration between the two regions including the proliferation of FTAs between them. Section VI recommends a set of policies that could be considered for enhancing policy-led integration between South Asia and East Asia.

II. Historical Relations between South Asia and East Asia

South Asia has a long history of economic ties and cultural and religious exchange with East Asia which date back to the pre-Christian era. The first millennium of the Christian era was a period of rapid growth for India and China. Trade ties between these two countries also increased and the expansion of trade links between these countries widened localized networks into regional ones.[3] Exports from India comprised mainly rice, sugar and cotton textiles, while imports were more varied and included Indonesian spices, various kinds of woods, Chinese silk, tea, gold and non-precious metals such as tin, copper and vermillion. India and China were in contact with each other through a network of land and sea routes. Land routes started off as localized networks and were gradually linked into long distant trading channel known as the Silk Road. There were two major maritime ports in the east coast of India, namely, the port of Coromandel (near present-day Chennai) and Bengal. There is evidence of extensive trade with Burma and Thailand. The opening of the straits of Malacca in the fifth century enabled direct contact with the northwestern edge of the Java Sea region where intra-regional trade was strong and led to the establishment of the Srivijaya Empire (present-day Indonesia). This together with the emergence of the Chola Empire in South India and the Sung Dynasty in China in the tenth and the eleventh centuries as large, unified, and prosperous regional powers, provided an additional fillip to regional economic trade and exchange. Strategically located on the route of the great maritime route connecting China and the West, Southeast Asia also provided a staging ground for

[3] For a more comprehensive discussion, see Shankar (2004), Mishap (2001), and Chanda (undated).

merchants from the East and the West. Various strategic alliances were also made. Rajendra I of the Chola dynasty conducted a naval expedition to Srivijaya to protect trade with China. Rajendrachola Deva I named the island of Singapore (Singapura) in the 10th century AD. Hence, during the pre-colonial period, in addition to being the dominant region of the world, Asia was one of the most integrated regions of the world. The latter fact is relatively less known.

Together with land and sea-borne borne commerce, trader, missionaries, priests, adventurers, and fortune seekers moved from South Asia to Southeast Asia. The Sanskrit language, Hinduism, and Buddhism were like old wine lacing East Asia's culture. Names from the Sanskrit language and various Hindu-Buddhist cults were adopted in East Asia. The common people too were influenced by the stories of the Ramayana, and various deities became popular.

During the colonial period (the 19th and early 20th centuries), Europeans (the Portuguese, the Spanish, the Dutch, the British, the French, and the Americans) were able to take control of international trade of Asia, thereby divert the profits from this trade to Europe. This distorted center-periphery relations made Europe stronger while the Asian Empires and kingdoms became weaker. Economic linkages between South Asia and East Asia also weakened as South Asian soldiers were used to quash rebellions in other parts of Asia such as China (the Opium War) and Malaya. It is only after the end of the colonial period that South Asia has once again started to re-engage with East Asia (Section V).

III. Quantitative Measures of Integration

Trade Integration

South Asia's total merchandise trade with East Asia (ASEAN+3) has grown significantly in absolute terms. It increased nearly eightfold in 1990–2006, from $12.4 billion to $96.8 billion, for an average annual growth rate of 14.6% (**figure 1**). The annual growth rate was relatively moderate until 2000, but it surged after that and averaged 26.2% in 2001–2006, with the largest increase being in 2006 (48.6%).[4]

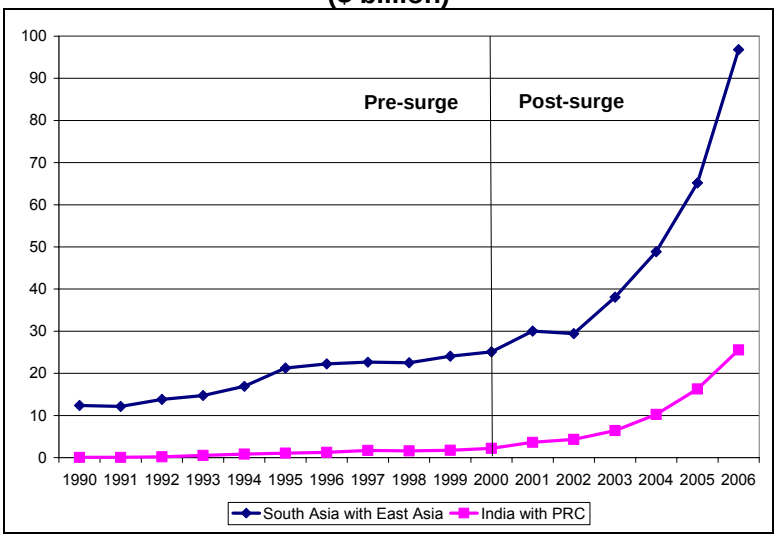
A large part of the increase in South Asia–East Asia trade is accounted for by the bilateral trade between the two giant economies of India and China, which has also increased rapidly in recent years. From $48.8 million in 1990, total trade between the two countries grew to $25.6 billion in 2006 (or about 26% of total trade between South Asia and East Asia). In 2001–2006, total trade between the two countries posted an average growth of about 51%, with growth reaching 57.1% in 2005–2006. At a recent "strategic partnership summit" earlier this year, the two countries agreed to triple the trade target to $60 billion by 2010, revising an earlier target of $40 billion which is expected to be achieved this year.

Although in 2006 South Asia–East Asia trade was higher than the volume of intra–South Asia trade ($16.2 billion), intra–Central Asia trade ($4.3 billion), and South Asia–Central Asia trade ($2.3 billion), it was very much lower than the level of intra–East Asia trade, which stood at $2 trillion (Table 1). In spite of this, South Asia–East Asia trade is the second-largest component of Pan-Asian trade.

[4] Except in 2002, when South Asia's exports to the Republic of Korea and Japan softened somewhat. Trade with other partners, however, surged.

Figure 1

Total Trade between South Asia and East Asia, 1990–2006
($ billion)



Source: IMF (2007).

Table 1

Pan-Asian Intra-regional and Inter-regional Trade, 2006

(in $ billion)

Intra-regional Trade:		
East Asia	2,003.1	(93.6%)
South Asia	16.2	(0.8%)
Central Asia	4.3	(0.2%)
Inter-regional Trade:		
South Asia-East Asia	96.8	(4.5%)
Central Asia-South Asia	2.3	(0.1%)
Central Asia-East Asia	18.1	(0.8%)
Total Pan-Asian Trade	**2,140.8**	(100%)

Note: Trade refers to Exports plus imports. Figures in parenthesis refer to share of Pan-Asian trade.

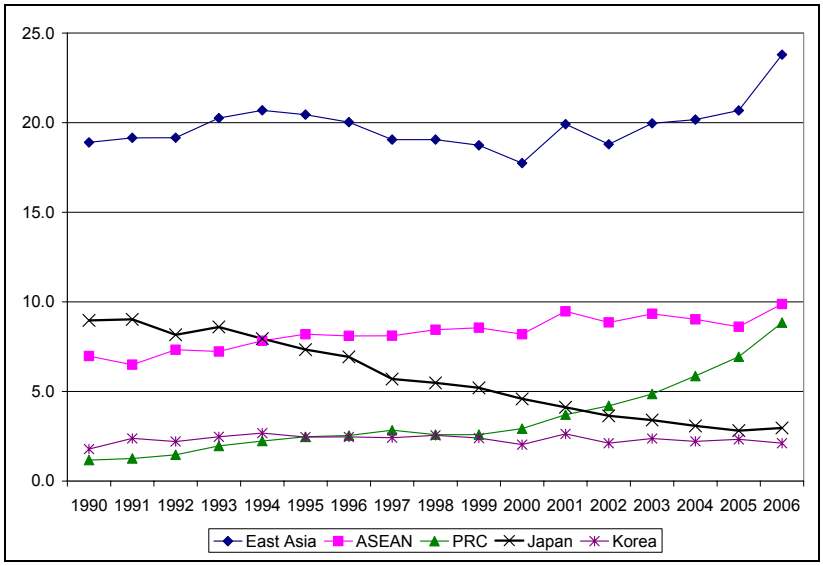
Source: IMF, Direction of Trade Statistics CD-Rom, June 2007.

Also relative to the volume of total trade, South Asia's trade with East Asia has not changed very much (**figure 2**). East Asia accounted for 18.9% of South Asia's trade in 1990 and about 21% in 1994, before it fell back to about 18% in 2000. Since then, however, East Asia's share has been increasing, reaching about 24% in 2006. South Asia's trade with the ASEAN countries increased steadily from about 7% in 1990 to about 10% in 2006. The same trend holds in the case of South Asia's trade with China, which has had more pronounced increases since 2000. In fact, in 2006, South Asia's total trade with China stood at about 9%, only slightly lower than its trade with ASEAN. On the other hand, South Asia's total trade with Japan declined sharply in 1990–2006, while South Asia's trade with the Republic of Korea, after a sluggish trend until 2001, started to decline slightly.

South Asia accounted for a mere 1.3% of East Asia's trade in 1990 and a slightly higher 1.9% in 2006 (**figure 3**). Hence, East Asia is a more important trading partner for South Asia than vice versa.

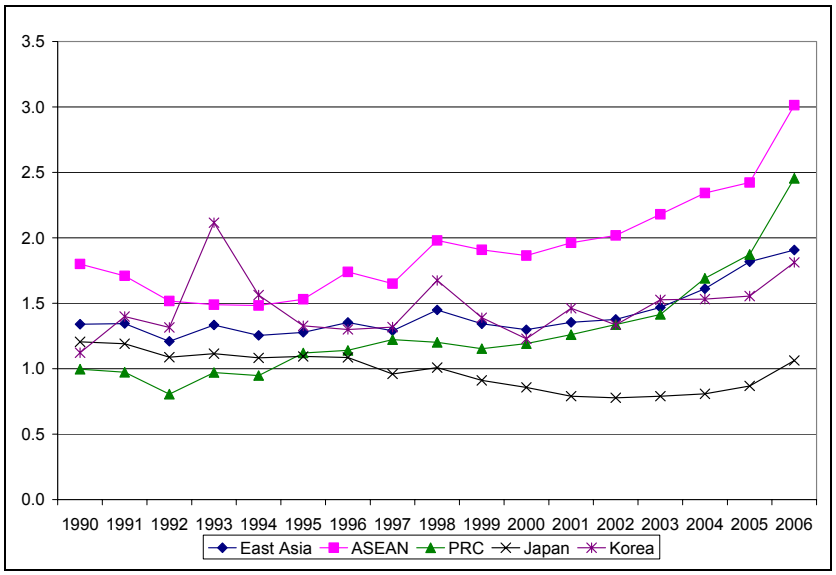
Figure 2

Interregional Trade between South Asia and East Asia (as a percentage of South Asia's Total Trade with the World), 1990–2006



Source: IMF (2007).

Figure 3
Interregional Trade between South Asia and East Asia
(as a percentage of East Asia's Total Trade with the World) , 1990–2006



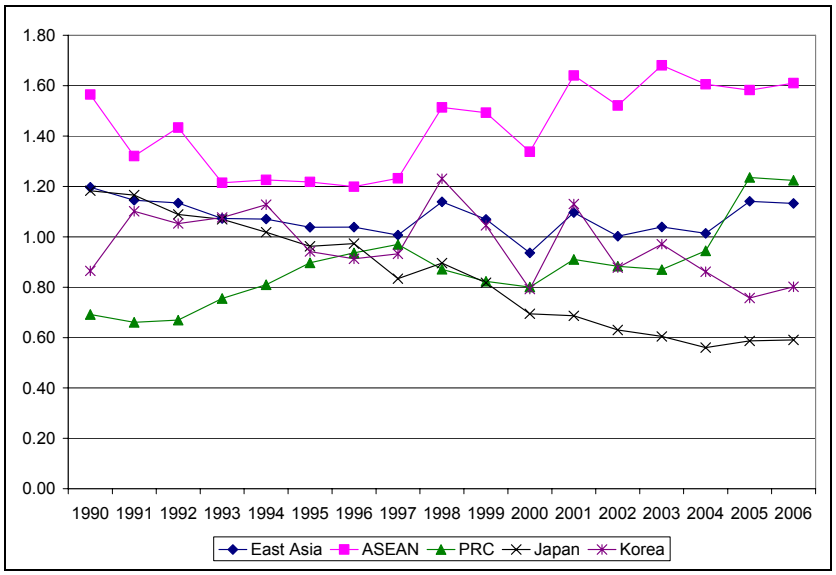
Source: IMF (2007).

Trade Intensity Index. Trade shares are not sufficient to assess the extent to which countries prefer to trade with each other than with their other trading partners in the rest of the world. Therefore, we also computed trade intensity indices to measure whether trade between two regions is greater relative to their importance in world trade.[5]

Figure 4 shows that trade intensity between South Asia and East Asia declined in 1990–2000 but has increased since then, from 0.9 to 1.1 in 2006. This reflects mainly the increasing trade intensity between South Asia and ASEAN and China. South Asia's trade intensity with Japan declined continuously during the period.

[5] The total Trade Intensity Index (TII) was computed as $TII_{ij} = (t_{ij}/T_{it})/(t_{wj}/T_{wt})$, where t_{ij} and t_{wj} are the values of country (or region) i's total trade and of world trade with country (or region) j, and T_{it} and T_{wt} are country i's total trade and total world trade, respectively.

Figure 4
Total Trade Intensity Index between South Asia and East Asia, 1990–2006



Source: IMF (2007).

Investment Integration

Data in **table 2** show that FDI inflows into China have grown rapidly, from $3.5 billion in 1990 to more than $72.4 billion in 2005. China is the second-largest recipient of FDI in the world (after the US) and the largest FDI recipient in Asia. Singapore, with $15 billion in 2005, is the second-largest recipient of FDI in Asia, followed by Thailand and Indonesia recently ($8.9 billion and $8.3 billion, respectively), and the Republic of Korea with about $7 billion.

Table 2
World Foreign Direct Investment Inflows into South Asia and East Asia, 1990, 1995, 2000, and 2005
($ million)

Country	1990	1995	2000	2005
South Asia	546.4	2,952.2	3,092.8	9,861.9
Bangladesh	3.2	1.9	280.4	692.0
Bhutan	1.6	0.1	(0.1)	9.0
India	236.7	2,151.0	2,319.0	6,676.0
Maldives	5.6	7.2	13.0	9.5
Nepal	5.9	8.0	(0.5)	2.4
Pakistan	250.0	719.0	308.0	2,201.0
Sri Lanka	43.4	65.0	173.0	272.0
East Asia	18,820.0	67,013.2	80,274.3	123,298.6
Japan	1,753.0	41.5	8,322.7	2,775.4
Brunei Darussalam	7.0	582.8	549.2	288.5
Cambodia	..	150.7	148.5	381.2
Indonesia	1,092.0	4,346.0	(4,550.0)	8,337.0
Korea, Republic of	759.0	1,250.0	8,591.0	7,049.5
Lao PDR	6.0	88.4	34.0	27.7
Malaysia	2,611.0	5,815.0	3,787.6	3,964.8
Myanmar	225.1	317.6	208.0	235.8
Philippines	550.0	1,459.0	1,345.0	1,854.0
PRC	3,487.1	37,520.5	40,714.8	72,406.0
Singapore	5,574.7	11,591.3	16,484.5	15,003.7
Thailand	2,575.0	2,070.0	3,350.0	8,954.0
Viet Nam	180.0	1,780.4	1,289.0	2,021.0

Source: UNCTAD, FDI Indicators Online.

Since the start of economic reforms in India in the early 1990s, FDI inflows have also started to grow, from a mere $237 million in 1990 to $6.7 billion in 2005. However, even now the level of FDI inflows into India is less than one-tenth of that in China. This gap is expected to lessen further in the future as it is now well accepted in India that FDI inflows have a critical role to play in today's global economy by providing resources and by facilitating technology transfer and improvements in managerial systems. Policies to attract FDI have been put in place as a result.

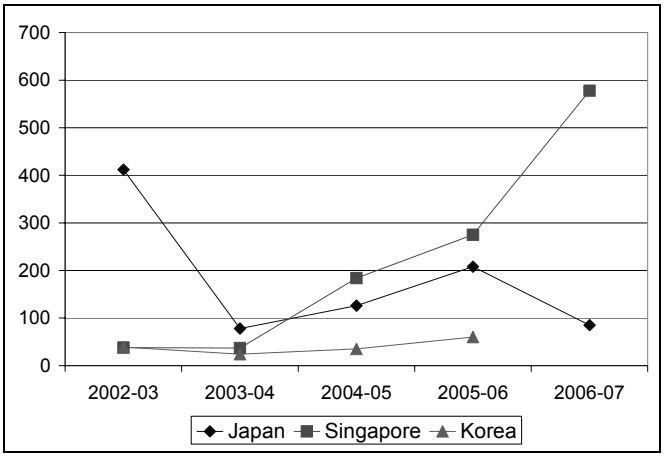
The absence of comparable data on FDI, by source, limits an analysis of investment relationships between South Asia and East Asia. The data that are available from national sources and the ASEAN Secretariat (**figures 5 and 6)** show that investment relationships between the two regions, although starting to increase in recent years, is still limited.

Figure 5a shows an increasing trend for FDI inflows into India from Japan, the Republic of Korea, and Singapore. An interesting finding is that since fiscal year 2004-2005 Singapore has overtaken Japan as the largest Asian source of FDI in India. This reflects the investments made in India by Singapore-based multinational corporations and Singapore's government-linked companies such as Singapore Telecom, Port of Singapore Authority, and Singapore Technologies. Singapore private sector companies have also made small-scale investments in health care, real estate, large townships, and tourism in India. Temasek's Indian portfolio tops S$3 billion and Singapore banks are now seeing opportunities in India. Singapore – India relations turned for the better a decade and half ago when the then Prime Minister Goh spoke of "sparking a mild India fever".

Figure 5b shows FDI inflows into Pakistan to be rising but small (relative to total FDI in Pakistan) from Japan, Singapore, and Hong Kong, China. **Figure 6** presents data on FDI outflows from selected South Asian countries to East Asia. These show some diversion of India's FDI away from ASEAN to China. In other words, while India's investments in the ASEAN countries have softened somewhat, they have increased in the case of the China. Once again, in relative terms the magnitude of this shift is not very large.

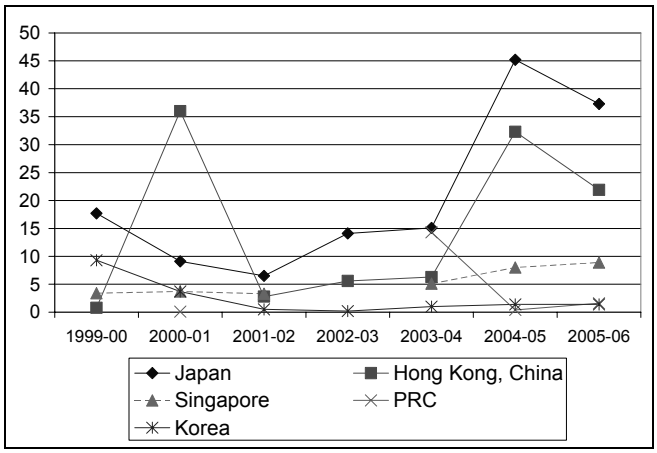
Figure 5
Foreign Direct Investment Inflows from Selected East Asian Countries into South Asia
($ million)

Figure 5a
Foreign Direct Investment Flows from Selected East Asian Countries to India, 2002/03–2006/07



Source: Ministry of Commerce and Industry of India.

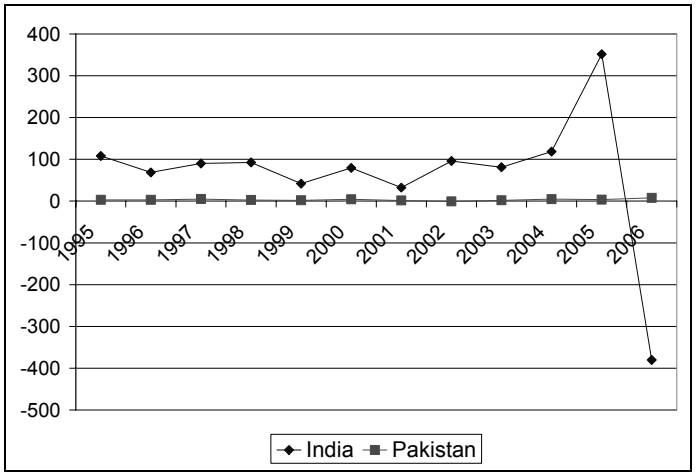
Figure 5b
Foreign Direct Investment Flows from Selected East Asian Countries to Pakistan 1999/00–2005/06



Source: State Bank of Pakistan.

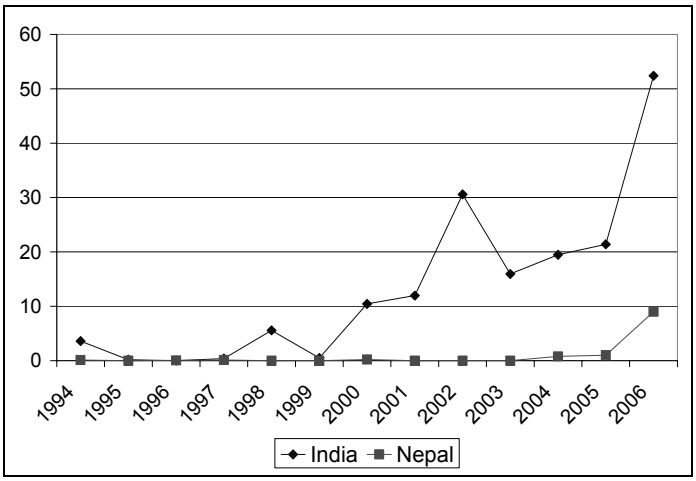
Figure 6
Foreign Direct Investment Inflows from Selected South Asian Countries into East Asia
($ million)

Figure 6a
Foreign Direct Investment Flows from Selected South Asian Countries to ASEAN, 1995–2006



Source: ASEAN Secretariat FDI Database.

Figure 6b
Foreign Direct Investment Flows from Selected South Asian Countries to China, 1994–2006



Source: *Chinese Statistical Yearbook*, various years.

According to the data provider Dealogic, in the first 9 months of 2006 Indian companies announced a record 112 foreign acquisitions with a combined deal value of $7.2 billion. In 2006, deals totaled $4.5 billion, which itself was thrice the figure for 2004. A noticeable feature of India's overseas expansion is that it focuses on Europe and the US and less on East Asia. That feature of its expansion is expected to continue into the future. An important constraint is that, although the Government has relaxed limits on the use of foreign exchange by Indian companies for overseas acquisitions, companies are still not permitted to undertake overseas acquisitions equivalent to more than two times their net worth.

IV. Economic Complementarities

Commodity Composition of Merchandise Trade

Tables 3 and 4 show the top 10 exports of South Asia and East Asia to each other at the two-digit SITC (Revision 3) level in 1990 and 2004. The data suggest that, in the case of South Asia, several unskilled labor-intensive goods dropped out of the top-10 list in 2004 as compared with 1990 (such as textile fibers, and clothing and accessories), while several capital-intensive goods (such as iron and steel, organic chemicals, and nonferrous metals) were added to the list. In the case of East Asia, power-generating machines and iron and steel dropped out of the top-10 list, while several capital- and knowledge-intensive goods (such as office machines and inorganic chemicals) were added to the list.

The data in the tables suggest that in 2004 there was a certain amount of complementarity between the two regions. South Asia's exports to East Asia comprise mainly agricultural, primary, and labor-intensive manufactured goods. A limited amount of petroleum products (such as kerosene, aviation turbine fuel, high-speed diesel oil, and light diesel oil) is also exported from India to East Asian countries such as Singapore. East Asia's exports to South Asia, on the other hand, comprise mainly items in the SITC 7 product group, which are more capital- and knowledge-intensive, such as telecommunications and sound recording equipment, electrical machinery, road vehicles, and industrial machines.

Table 3
Top 10 Exports of South Asia to East Asia, 1990 and 2004

Rank	SITC Code	Commodity	Amount ($ million)
1990			
1	S3-66	Nonmetallic mineral manufactures	769.0
2	S3-65	Textile yarn, fabric, etc.	755.0
3	S3-28	Metalliferous ore, scrap	514.0
4	S3-03	Fish, crustaceans, molluscs	376.0
5	S3-26	Textile fibers	327.0
6	S3-84	Clothing and accessories	117.0
7	S3-61	Leather, leather goods	113.0
8	S3-33	Petroleum, petroleum products	92.4
9	S3-93	Special transactions not classified elsewhere	83.3
10	S3-27	Crude fertilizer, minerals	80.9
2004			
1	S3-28	Metalliferous ore, scrap	3,470.0
2	S3-33	Petroleum, petroleum products	2,400.0
3	S3-66	Nonmetallic mineral manufactures	1,420.0
4	S3-67	Iron and steel	1,270.0
5	S3-65	Textile yarn, fabric, etc.	1,220.0
6	S3-51	Organic chemicals	1,050.0
7	S3-03	Fish, crustaceans, molluscs	667.0
8	S3-57	Plastics in primary form	562.0
9	S3-68	Nonferrous metals	510.0
10	S3-08	Animal feedstuff	481.0

SITC = Standard International Trade Classification.
Source: Computed from UN COMTRADE Online using Stata Package 9.0.

Table 4
Top 10 Exports of East Asia to South Asia, 1990 and 2004

Rank	SITC Code	Commodity	Amount ($ million)
1990			
1	S3-33	Petroleum, petroleum products	753.0
2	S3-78	Road vehicles	621.0
3	S3-65	Textile yarn, fabric, etc.	604.0
4	S3-67	Iron and steel	578.0
5	S3-77	Electrical machinery, apparatus, parts, NES	462.0
6	S3-72	Specialized industrial machinery	453.0
7	S3-74	General industrial machineries	431.0
8	S3-42	Fixed vegetable fats and oils	363.0
9	S3-71	Power-generating machines	266.0
10	S3-76	Telecommunications, sound equipment, etc.	216.0
2004			
1	S3-65	Textile yarn, fabric, etc.	3,600.0
2	S3-76	Telecommunications, sound equipment, etc.	3,120.0
3	S3-42	Fixed vegetable fats and oils	2,490.0
4	S3-77	Electrical machinery, apparatus, parts, NES	2,370.0
5	S3-75	Office machines, ADP machines	2,090.0
6	S3-78	Road vehicles	2,080.0
7	S3-72	Specialized industrial machinery	1,800.0
8	S3-51	Organic chemicals	1,790.0
9	S3-33	Petroleum, petroleum products	1,720.0
10	S3-74	General industrial machineries	1,660.0

ADP = automatic data-processing, NES = not elsewhere specified, SITC = Standard International Trade Classification.
Source: Computed from UN COMTRADE Online using Stata Package 9.0.

Revealed Comparative Advantage Indices for Merchandise Trade

Table 5 presents the revealed comparative advantage (RCA) indices for South Asia, calculated at the two-digit SITC level.[6] The data presented are only for those commodities whose indices are equal to or above unity in 2004, signifying comparative advantage; these indices are compared with their corresponding values in 1993. The table shows that the products for which South Asia had comparative advantage in 2004 were mainly primary goods and labor-intensive manufactures.[7] Textiles, yarn and fabrics, and clothing and accessories showed the highest RCA indices in 2004 (and in 1993), and this may have been

[6] RCA indices can be used to assess a country's (or region's) export potential. It is measured by a product's share in the country's exports in relation to its share in world trade. The RCA index of country *i* for product *j* is computed as: $RCA_{ij} = (x_{ij}/X_{it})/(x_{wj}/X_{wt})$, where x_{ij} and x_{wj} are the values of country (region) *i*'s exports of product *j* and world exports of product *j*, and where X_{it} and X_{wt} refer to the country's (region's) total exports and world total exports, respectively. An index that exceeds unity means the country (region) has a revealed comparative advantage in the product; a value less than unity implies a comparative disadvantage. Countries (regions) with similar RCA profiles are unlikely to have high bilateral trade intensities unless intra-industry trade is involved.

[7] India also has comparative advantage in iron and steel, which is capital-intensive.

the result of the Multi-Fiber Agreement, which granted privileged access to garment exporters. **Table 6** shows the merchandise goods in which individual South Asian countries had comparative advantage in 2004.

Table 5
Revealed Comparative Advantage Indices for South Asia, 1993 and 2004

SITC Code	Description	RCA Indices		Rank	
		1993	2004	1993	2004
S3-65	Textile yarn, fabric, etc.	6.6	6.0	1	1
S3-84	Clothing and accessories	6.5	5.8	2	2
S3-66	Nonmetallic mineral manufactures	5.7	5.7	5	3
S3-61	Leather, leather goods	6.2	4.5	4	4
S3-07	Coffee, tea, cocoa, spices	6.4	3.9	3	5
S3-28	Metalliferous ore, scrap	2.1	3.4	10	6
S3-04	Cereals, cereal preparations	1.6	3.2	14	7
S3-27	Crude fertilizer, mineral	2.0	2.8	11	8
S3-03	Fish, crustaceans, molluscs	3.7	2.6	7	9
S3-83	Travel goods, handbags, etc.	3.1	2.3	9	10
S3-08	Animal feedstuff	4.1	1.9	6	11
S3-43	Animal, vegetable fats, oils, NES	0.4	1.8	31	12
S3-26	Textile fibers	3.6	1.8	8	13
S3-29	Crude animal, vegetable materials	2.0	1.7	12	14
S3-89	Misc. manufactured goods, NES	0.8	1.6	25	15
S3-85	Footwear	1.8	1.5	13	16
S3-67	Iron and steel	0.8	1.5	24	17
S3-12	Tobacco, tobacco manufactures	1.1	1.3	18	18
S3-51	Organic chemicals	0.5	1.2	30	19
S3-22	Oilseed, oleaginous fruit	1.0	1.2	20	20
S3-05	Vegetables and fruit	1.3	1.1	16	21
S3-33	Petroleum, petroleum products	0.3	1.1	37	22
S3-53	Dyes, coloring materials	1.4	1.1	15	23
S3-69	Metal manufactures, NES	0.7	1.0	26	24
S3-62	Rubber manufactures, NES	1.0	1.0	19	25

NES = not elsewhere specified, RCA = revealed comparative advantage, SITC = Standard International Trade Classification.
Note: Data limitations exclude Bhutan, Maldives, and Nepal from the computations.
Source: Computed from UN COMTRADE Online using Stata Package 9.0

Table 6
Commodities in Which Various South Asian Countries have Comparative Advantage, 2004*

Country	Commodity
Bangladesh	Clothing and accessories, leather and leather goods, fish, textile fibers, textile yarn, fabric, tobacco and tobacco manufacturing (increase in RCA of clothing and accessories, tobacco and tobacco manufacturing; decline in RCA of leather and leather goods, textile fibers, textile yarn and fabrics)
India	Nonmetal mineral manufacturing, textile yarn, fabric, cereals, coffee, tea, animal feedstuff, iron and steel, footwear, organic chemicals, dyes, petroleum products, oilseed, tobacco and tobacco manufacturing, vegetables and fruits, animal and vegetable fats and oils, plastics in primary form, rubber manufactures (some decline in RCA of level 0 and 6 products except cereals, and iron and steel, which increased; increase in RCA of petroleum and petroleum products)
Pakistan	Textile yarn, fabric, leather and leather goods, clothing and accessories, cereals, animal and vegetable fats and oils, sugar, fish, furniture, beddings, footwear, other transport equipment, vegetables and fruits (some increase in RCA of level 8 products)
Sri Lanka	Coffee, tea, clothing and accessories, textile fibers, yarn, fabric, crude rubber, rubber manufactures, tobacco and tobacco manufacturing, animal and vegetable fats and oils, fish, travel goods, handbags, vegetables and fruits, nonferrous metals, crude animal or vegetable material, other transport equipment (increase in RCA of coffee, tea and spices, clothing and accessories, rubber manufacturing, nonferrous metals, other transport equipment; relatively no change for other products)

RCA = revealed comparative advantage.
*Changes since 1993 are in parentheses.

The RCA indices for East Asia, on the other hand, show that this region has comparative advantage across a much wider range of goods (**table 7**). These include primary goods such as crude rubber and fish; labor-intensive manufactured goods such as textiles, travel goods, and footwear; and more capital- and knowledge-intensive items such as office machines and telecommunications equipment. **Table 8** shows commodities in which individual East Asian countries have comparative advantage.

Table 7
Revealed Comparative Advantage Indices for East Asia, 1993 and 2004

SITC Code	Description	RCA Indices		Rank	
		1993	2004	1993	2004
S3-23	Crude rubber	2.5	2.4	1	1
S3-75	Office machines, ADP machines	1.8	2.1	4	2
S3-76	Telecom, sound equipment, etc.	2.3	2.0	2	3
S3-83	Travel goods, handbags, etc.	2.1	1.8	3	4
S3-77	Elect. mach., apparatus, parts, NES	1.6	1.8	8	5
S3-43	Animal, vegetable fats, oils, NES	1.6	1.6	7	6
S3-88	Photog. apparatus, NES; clocks	1.7	1.6	6	7
S3-42	Fixed vegetable fats and oils	1.6	1.6	10	8
S3-85	Footwear	1.6	1.5	9	9
S3-84	Clothing and accessories	1.5	1.5	11	10
S3-65	Textile yarn, fabric, etc.	1.4	1.4	12	11
S3-73	Metalworking machinery	1.1	1.2	15	12
S3-32	Coal, coke, briquettes	0.5	1.2	44	13
S3-03	Fish, crustaceans, molluscs	1.3	1.1	13	14
S3-89	Misc. manufactured goods, NES	1.0	1.0	18	15
S3-62	Rubber manufactures, NES	1.1	1.0	16	16
S3-87	Scientific equipment, NES	0.8	1.0	26	17

ADP = automatic data-processing, NES = not elsewhere specified, RCA = revealed comparative advantage, SITC = Standard International Trade Classification.
Note: Brunei, Cambodia, and Viet Nam are excluded from the computations because of data limitations.
Source: Computed from UN COMTRADE Online using Stata Package 9.0.

Table 8
Commodities in Which Various East Asian Countries Have Comparative Advantage, 2004*

PRC	Travel goods, handbags, footwear, clothing and accessories, office machines, coal, coke, textile yarn, fabric, telecom and sound equipment, prefabricated buildings and fittings, furniture, bedding, metals manufacturing, fish, inorganic chemicals, leather and leather goods, cork, wood manufacturing, electrical machinery and apparatus, crude fertilizer, photographic apparatus (increase in RCA of level 7 products; decline in RCA of most level 8 products and several level 0 products)
Indonesia	Fixed vegetable fats and oils, crude rubber, coal, coke, cork and wood manufactures, coffee, tea, metalliferous ore, scrap, fish, pulp and wastepaper, footwear, natural and manufactured gas, furniture, bedding, clothing and accessories, paper and paperboard, textile yarn, fabric, textile fibers, petroleum products, tobacco and tobacco manufacturing, nonferrous metals, cork and wood, rubber manufacturing (increase in RCA of level 2, 4 products; decrease in RCA of petroleum and petroleum products)
Japan	Photo apparatus, metalworking machinery, special industrial machinery, road vehicles, electrical machinery and apparatus, rubber manufacturing, power-generating machines, general industrial machineries, iron and steel, telecom and sound equipment, plastic in non-primary form, chemical materials, organic chemicals, other transport equipment (increase in RCA of level 5 products and some level 7 products; decline in RCA of telecom and sound equipment)
Korea, Republic of	Gold, telecom, sound equipment, other transport equipment, plastics in primary form, textile yarn, fabric, textile fibers, office machines, electrical machinery and apparatus, iron and steel, leather and leather goods, organic chemicals, road vehicles, crude rubber, rubber manufacturing (increase in RCA of level 5 and 7 products; decline in RCA of level 6 products)
Malaysia	Animal and vegetable fats and oils, coffee, tea, furniture, bedding, crude rubber, natural and manufactured gas, petroleum products, office machines, telecom and sound equipment, furniture, bedding (increase in RCA of animal and vegetable fats/oils, and office machines; decline in RCA of fixed vegetable fats/oils, crude rubber, cork and wood manufactures, telecom and sound equipment)
Philippines	Fixed vegetable fats and oils, electrical machinery and apparatus, vegetables and fruits, fish, sugar and sugar preparations, tobacco and tobacco manufacturing, clothing and accessories, special transactions not classified elsewhere (increase in RCA of level 7 products; decline in RCA of level 0 products)
Singapore	Electrical machinery, office machines, petroleum products, organic chemicals, photographic apparatus, plastics in primary form, telecom and sound equipment, special transactions not classified elsewhere (increase in RCA of electrical machinery and apparatus, plastics in primary form, and organic chemicals; decline in RCA of office machines, petroleum products, telecom and sound equipment)
Thailand	Crude rubber, sugar and sugar preparations, cereals, plastics in primary form, rubber manufacturing, office machines, electrical machinery and apparatus, textile fibers, vegetables and fruits, leather and leather goods, footwear, furniture, crude fertilizer, clothing and accessories, textile yarn, fabric, photographic apparatus, animal feedstuff, animal and vegetable fats and oils, furniture, bedding, footwear, telecom and sound equipment (increase in RCA of crude rubber, plastics in primary form, textile fibers, photographic apparatus and clocks, and animal and vegetable fats/oils; decline in RCA of several level 0 and level 8 products)

RCA = revealed comparative advantage.
*Changes since 1993 are in parentheses.

Tables 5 and 7 suggest that RCAs for South Asian and East Asian countries changed somewhat in 1993 and 2004. A more formal test for this is to calculate the Spearman rank correlation coefficients between the 1993 and 2004 values (**table 9**). The data in **table 9** show that in East Asia, China has the lowest coefficient (0.667), and this suggests that the country has experienced the largest change in its comparative advantage compared with other countries in the East Asian region. Although not shown, our RCA calculations for China reveals that many primary goods, including live animals, fruits and vegetables, and cereals, changed from comparative advantage to disadvantage from 1993 and 2004. On the other hand, there has been an increase in the China's RCA indices for most manufactured goods, such as telecommunications and sound equipment, metal manufactures, prefabricated fittings, electrical machinery parts, and office machines.

In South Asia, Bangladesh has the lowest coefficient (0.552), suggesting a relatively higher change in RCA compared with the other South Asian countries. Bangladesh's RCA in clothing and textiles decreased, while that in leather and leather goods increased. For all the countries in both regions, however, the correlation coefficients are quite high (close to unity) and statistically significant at the 1% level, indicating no significant change in RCA.

Table 9
Spearman Rank Correlation Coefficients for Revealed Comparative Advantage Indices,
1993 and 2004

Country	Spearman's Rho	No. of Observations
South Asia	0.859*	65
Bangladesh	0.552*	51
India	0.869*	65
Pakistan	0.736*	58
Sri Lanka	0.709*	61
East Asia	0.860*	66
Indonesia	0.849*	64
Japan	0.948*	65
Korea, Republic of	0.803*	63
Malaysia	0.775*	65
Philippines	0.714*	63
PRC	0.667*	64
Singapore	0.797*	65
Thailand	0.825*	65

Note: South Asia and East Asia here consist of only those countries listed above.
*Significant at 1%.
Source: Computed from UN COMTRADE Online using Stata Package 9.0.

Trade Complementarity Indices

One possible explanation for the increasing integration between South Asia and East Asia is that the regions' export and import demand profiles have become more "complementary" over time. That is, goods exported by South Asia are becoming increasingly similar to the goods imported by East Asia, and vice versa. We calculated the so-called "trade complementarity index" for pairs of South and East Asian countries using SITC two-digit data in 1993 and 2004. The results are presented in **table 10**.[8] The first set of data refers to the similarity of South Asia's exports with East Asia's imports, and the second to the similarity of East Asia's exports with South Asia's imports. The data show that while the complementarity of India's and Pakistan's trade with various East Asian countries has increased, the results are more mixed in the case of Sri Lanka. The complementarity of Bangladesh's trade with East Asia has, however, declined. The overall index for South Asia as a group suggests that South Asia has been increasingly exporting the commodities that East Asia is importing (the complementarity index increased from 40 to 48), while the complementarity of East Asia's exports with South Asia's imports has not changed very much (the index has remained at around 49).

[8] The Trade Complementarity Index (TCI) between countries (or regions) k and j were computed as: $TCI = 100 - sum(|m_{ik} - x_{ij}|/2)$, where x_{ij} is the share of good i in global exports of country j, and m_{ik} is the share of good i in total imports of country k. The index shows how well the structures of a country's (or region's) imports and exports match. The index is 0 when no goods are exported by one country or imported by the other, and 100 when the export and import shares exactly match.

Table 10
Trade Complementarity Indices between South Asia and East Asia, 1993 and 2004

Trading Partners		Similarity of South Asia's Exports to East Asia's Imports		Similarity of South Asia's Imports to East Asia's Exports	
		1993	2004	1993	2004
South Asia	**East Asia**	39.5	47.9	49.1	48.3
Bangladesh	Indonesia	16.8	9.6	38.1	46.0
	Japan	26.1	17.7	39.2	37.6
	Korea, Rep. of	17.9	12.1	47.6	43.8
	Malaysia	12.6	7.2	38.4	37.2
	Philippines	13.5	7.9	26.8	24.1
	PRC	20.0	9.5	47.9	38.0
	Singapore	12.3	6.4	43.4	34.0
	Thailand	14.5	10.1	37.6	44.4
India	Indonesia	37.9	51.5	40.4	49.6
	Japan	49.0	54.6	36.1	39.4
	Korea, Rep. of	36.2	49.3	37.6	43.7
	Malaysia	34.8	41.2	32.4	42.2
	Philippines	38.2	41.5	31.0	24.9
	PRC	37.9	47.7	33.4	37.0
	Singapore	33.5	38.5	43.2	43.0
	Thailand	37.4	52.5	28.5	38.9
Pakistan	Indonesia	18.6	21.2	40.2	46.9
	Japan	27.5	26.6	46.4	45.4
	Korea, Rep. of	19.5	20.8	41.1	48.6
	Malaysia	14.8	18.8	38.0	38.7
	Philippines	15.7	17.0	24.9	23.9
	PRC	20.4	18.8	33.7	34.9
	Singapore	15.7	18.8	44.3	42.9
	Thailand	15.1	19.9	29.0	43.1
Sri Lanka	Indonesia	15.0	18.7	38.8	50.1
	Japan	30.1	28.3	43.1	40.5
	Korea, Rep. of	18.4	21.1	52.8	49.0
	Malaysia	18.5	20.2	38.0	39.1
	Philippines	17.5	16.5	28.5	27.1
	PRC	16.6	19.5	50.9	42.7
	Singapore	20.8	18.2	43.6	39.9
	Thailand	20.1	22.6	42.2	52.2

Source: Computed from UN COMTRADE Online using Stata Package 9.0.

Trade in Commercial Services

With the rapid changes in technology and globalization, trade in commercial services is becoming increasingly more important in both the South and East Asian countries. However, unlike in merchandise trade, bilateral data on the trade in services are unavailable. Hence, analysis is restricted to service exports from those countries and their breakdown into various sectors that are available in IMF's balance-of-payments statistics.

Table 11 shows that the service exports of both South Asia and East Asia quadrupled in 1990–2004 to about $30 billion in South Asia and about $344 billion in East Asia. India is the largest exporter of services in South Asia, while China, the Republic of Korea, and Singapore are the largest exporters in East Asia aside from Japan. Data in **table 12** show that information and communication technology (ICT) (which comprises communication services and computer and information services) accounts for the bulk of the increase in the service exports of India. In 2003, ICT accounted for about 53% of India's service exports. In the case of China, however, travel (business and tourism) is the most significant portion of service exports, accounting for about 40% of the total in 2004.

Table 11
Exports of Commercial Services, 1990, 1995, 2000, and 2005
($ million)

Country	1990	1995	2000	2005*
South Asia	7,190.8	11,061.2	20,671.9	30,556.7
Bangladesh	391.6	698.2	815.1	1,245.4
India	4,624.9	6,774.7	16,683.7	23,396.6
Maldives	101.1	232.8	348.5	317.2
Nepal	204.4	679.0	505.9	380.4
Pakistan	1,429.3	1,857.3	1,380.0	3,677.0
Sri Lanka	439.6	819.2	938.7	1,540.1
East Asia	44,472.2	111,694.1	131,382.0	344,610.4
Cambodia	n.a.	114.0	428.4	1,106.5
Indonesia	2,488.0	5,469.0	5,214.1	12,925.5
Japan	41.4	65.3	69.2	110,210.0
Korea, Republic of	9,636.9	22,827.3	30,533.6	45,374.6
Lao PDR	23.7	96.8	175.7	166.1
Malaysia	3,859.0	11,601.6	13,940.5	19,575.7
Myanmar	94.4	364.6	477.9	254.7
Philippines	3,244.0	9,348.0	3,972.0	4,462.0
PRC	5,855.0	19,130.3	30,430.5	74,404.1
Singapore	12,810.8	27,832.1	29,569.9	51,307.9
Thailand	6,419.0	14,845.2	13,868.2	20,647.3
Viet Nam	n.a.	n.a.	2,702.0	4,176.0

* Latest figures are 2001 for Lao PDR, 2003 for India, and 2004 for Myanmar.
Source: IMF (2007a).

Table 12
Commercial Service Exports for India and China by Sector, 1990, 1995, 2000, 2003, and 2004
($ million)

Country/Service Sector	1990	1995	2000	2003	2004
India					
Transportation	959.4	1,890.4	1,978.7	3,061.6	
Travel	1,558.4	2,581.5	3,459.9	3,887.1	
Communication services	n.a.	n.a.	598.8	1,065.9	
Construction services	n.a.	n.a.	501.9	284.1	
Insurance services	123.3	170.2	257.0	408.9	
Financial services	n.a.	n.a.	276.0	392.1	
Computer and information services	n.a.	n.a.	4,727.4	11,365.7	
Royalties and license fees	1.3	1.4	82.6	25.2	
Other business services	1,967.1	2,119.7	4,147.8	2,601.0	
Government services	15.4	11.5	653.7	305.1	
Total Services	**4,624.9**	**6,774.7**	**16,683.7**	**23,396.6**	
PRC					
Transportation	2,706.0	3,352.1	3,671.0	7,906.4	12,067.5
Travel	1,738.0	8,730.0	16,231.0	17,406.0	25,739.0
Communication services	159.0	755.7	1,345.5	638.4	440.5
Construction services	n.a.	n.a.	602.3	1,289.7	1,467.5
Insurance services	227.0	1,852.1	107.8	312.8	380.8
Financial services	n.a.	n.a.	77.8	152.0	94.0
Computer and information services	n.a.	n.a.	356.0	1,102.2	1,637.2
Royalties and license fees	n.a.	n.a.	80.4	107.0	236.4
Other business services	918.0	3,740.0	7,663.0	17,427.0	19,951.9
Personal, cultural, and recreational services	n.a.	n.a.	11.3	33.4	41.0
Government services	107.0	700.3	284.5	358.8	378.5
Total Services	**5,855.0**	**19,130.3**	**30,430.5**	**46,733.6**	**62,434.1**

n.a. = not available.
Source: IMF (2007a).

India has become the leading destination for the outsourcing of ICT services, call-center support, and other back-end business operations (like data entry and handling, payroll management, accounting and bookkeeping, and ticketing). However, in spite of rapid growth, India's share of the global software market is still small. Also, while the software industry in India is diversifying into new areas with strong growth potential, the hardware industry is only now beginning to receive the requisite attention of policy makers and industry. Cooperation with East Asian countries that have developed such capabilities could create synergies for mutual benefits in this area (Sen, Asher, and Rajan 2004).

RCA indices for various commercial service trade sectors in 2004[9] presented in **table 13** suggest a certain degree of complementarity between South Asia and East Asia. South

[9] 2003 for India and Malaysia.

Asia has complementarity in ICT (India and Sri Lanka), and travel (business and tourism) (Maldives, Nepal, and Sri Lanka), and East Asia in royalties on licenses for the authorized use of proprietary rights (Japan and Republic of Korea), financial services and insurance (Singapore), construction services (PRC, Indonesia, Japan, Malaysia, and Philippines), and travel (business and tourism) (Cambodia, PRC, Malaysia, Philippines, and Thailand).

Table 13
Revealed Comparative Advantage in Services, 2004

Country	Service Sector
South Asia	
Bangladesh	Communications
India	Computer and information, communications
Maldives	Travel
Nepal	Communications, travel
Pakistan	Communications, transportation
Sri Lanka	Transportation, insurance communications, computer and information, construction, travel
East Asia	
Cambodia	Travel, communications
Indonesia	Communications, business, construction
Japan	Royalties and licenses, construction, transportation
Korea, Rep. of	Business, royalties, and licenses
Malaysia	Personal, cultural, and recreational; travel; construction
Philippines	Communications, travel, transportation, construction
PRC	Travel, construction
Singapore	Business, transportation, financial, insurance
Thailand	Travel

Source: Computed from IMF (2006), using Stata Package 9.0.

V. Ongoing Policy Efforts

After the end of the colonial era that South Asia once again started to re-engage with East Asia. The Asian Relations Conference held in New Delhi in 1947 under the leadership of Jawaharlal Nehru served as one of the earliest attempts to form a Pan-Asian identity. Forming a common cause with other Asian leaders on decolonization, Western imperialism, equality and developing-world solidarity, Nehru helped to forge the “Bandung Spirit” of 1955 which led to the non-aligned movement. This phase of India’s engagement with East Asia, however, ended with India’s border war with China in 1962, and

preoccupation with Pakistan. India turned inward and adopted the Soviet model of development.

India started to enhance its linkages with East Asia only in 1992 when it launched its "Look East" policy" in the aftermath of the Cold War and the start of its economic liberalization policies. Under the Congress Government of Manmohan Singh, the "Look East" policy has been reenergized with renewed focus on India's place in the global economy. Other South Asian countries have also followed suit. "Look East" policies in South Asia have sought to establish trade and investment links with the dynamic ASEAN and now the East Asian countries. India's engagement with ASEAN began as a sectoral dialogue partnership in 1992, which was upgraded into a full dialogue partnership in 1995 and membership in the ASEAN Regional Forum in 1996. The first summit-level interaction began in November 2002. A Long-Term Vision 2020 paper for the ASEAN-India partnership has been prepared and is under implementation. Since 1995, India has also participated in the East Asia Summits that brings together the heads of states and governments of ASEAN +3 plus Australia, New Zealand, and India. At the Summit in Singapore last year, it was decided to revive the 3000-year old Nalanda University in India as a Pan-Asian center of excellence. The recent observer status given to China and Japan in the SAARC also portends well for South Asia-East Asia economic relations. Observer status to Korea and ASEAN is also being considered. At the 2006 Asia-Europe Finance Ministers' meeting, a decision was made to expand membership to include India, Pakistan, Mongolia, and the ASEAN Secretariat from the Asian side, and Rumania and Bulgaria from the European side.

More recently, as in other parts of the world, there has been a proliferation of FTAs between South Asia and East Asia. The most significant of these so far is the signing of the India-Singapore Comprehensive Economic Cooperation Agreement (CECA) on June 2005. The CECA, which took effect in August 2005, covers trade not only in goods but also in services, investments, and cooperation in technology, education, air services, and human

resources. Various South Asian countries are also members of the Asia-Pacific Trade Agreement under the UN Economic and Social Commission for Asia and the Pacific (ESCAP). In addition, eight FTA framework agreements have been signed between South and East Asian countries (Appendix 1). These are the ASEAN-India, India-Thailand, BIMSTEC, PRC-Pakistan, India–Republic of Korea, Malaysia-Pakistan, Pakistan-Singapore, and Pakistan-Indonesia FTAs. Another six FTAs have been proposed—between China and India, Japan and India, Malaysia and India, Pakistan and the Philippines, Pakistan and Thailand, and Singapore and Sri Lanka.

Several infrastructure projects also bring South Asia closer to East Asia. These countries are participating in UN ESCAP's Asian Highway Network (Figure 4.8c) and the Trans-Asian Railway Network. Discussions are also proceeding on reopening the World War II era Stillwell Road linking the Assam state with China's Yunnan Province through Myanmar. This follows the reopening of a direct overland trade route along the Nathu La pass on the border between Sikkim and Tibet in July 2006 after 44 years.

As the economic dynamism of the South Asian and East Asian regions continues, economic relations between South Asia and East Asia are expected to increase further. What distinguishes the present engagement with East Asia from the previous one during the pre-colonial period is that it is operating on multiple fronts: South Asia's historical, cultural, and idealogical links are being complemented by growing economic interdependence including movement of capital and human resources and a growing number of free trade agreements and security relationships.

VI. Policy Recommendations

The major findings of this paper are:

- The level of economic integration between South Asia and East Asia, although increasing since 1990, started to surge after 2000, albeit from a low base, mainly because of growing interdependence between India and China.
- Despite the acceleration, the level of integration between the two regions is low in relative terms.
- Given the complementarities between the two regions and ongoing policy efforts, economic integration is bound to increase much more in the future.

Which policy actions could be taken to increase the level of South Asia–East Asia integration? First, although tariffs and NTBs are already low in many East Asian countries and South Asia has made encouraging progress in the same direction since the 1990s, there appears to be room for further reductions in tariffs and NTBs in both regions (especially NTBs in East Asia). **Table 14,** which is based on the recently released Trade Restrictiveness Index of the World Bank, suggests that the average ad valorem tariff is 25.9% in the South Asian region and 18.2% in East Asia. In South Asia, the ad valorem tariff is 38.9 % in Nepal; 33.6 % in India; about 20%–23% in Bangladesh, Bhutan, and Pakistan; and 16% in Sri Lanka. NTBs are important instruments of protection in four of the six South Asian countries (except Sri Lanka and Pakistan). In East Asia, ad valorem tariff levels are highest in Malaysia and Viet Nam (about 26%), followed by China and Thailand (about 19%). But NTBs are high in all the countries, especially in Indonesia, the Philippines, and Viet Nam. South Asian countries need to reduce tariffs and NTBs further so that they can participate more effectively in the global production networks centered in East Asia while developing regional production networks of their own. Service trade liberalization in East Asia could also spur South Asia's ICT exports.

Table 14
Trade Restrictiveness Indices
(percentage)

Country	Tariffs Only	Tariffs and NTBs	% Change due to NTBs
South Asia	25.9	32.7	26.2
Bangladesh	23.6	30.7	30.1
Bhutan	20.5	28.2	37.6
India	33.6	50.8	51.2
Nepal	38.9	39.0	0.3
Pakistan	22.9	31.3	36.7
Sri Lanka	15.8	16.0	1.3
East Asia	18.2	36.7	102.2
PRC	19.4	31.4	61.9
Indonesia	10.6	23.4	120.8
Malaysia	26.2	47.6	81.7
Philippines	7.3	41.0	461.6
Thailand	19.5	25.9	32.8
Viet Nam	25.9	50.9	96.5

NTBs = nontariff barriers.
Source: Hiau, Nicita, and Olarreaga (2006).

Second, besides reducing tariffs and NTBs, South Asian countries and several East Asian countries also need to make progress in implementing the so-called second-generation reforms to increase transparency, good governance, and the quality of fiscal adjustment. These reforms include, among others, reform of the civil service and the delivery of public goods, creation of an environment that is conducive to private sector opportunities (greater competition, better regulations, and stronger property rights), and reform of institutions that create human capital (e.g., health and education). India is on the cusp of something big. Economic growth since the early 1990s (6% and 8% in the last 4 years) is expected not only to continue but to accelerate further because, among other things, one-half of the population is below the age of 25 and a demographic dividend can be expected. But this growth will happen only if India makes progress with the second-generation reforms, particularly in education and health. Recently, public debt has been too high and this discourages investment in much-needed infrastructure development. The banking and insurance sectors have also not been opened up to encourage long-term financing for infrastructure development. The public sector is large and inefficient with much red tape. Severe labor laws cover only 10% of workers, but, once hired, laborers cannot be fired. By and large, this argument holds for other South Asian countries as well.

The World Bank's comprehensive index measuring ease of doing business (World Bank 2006), which ranks 155 countries on 10 topics (starting a business, dealing with

licenses, hiring and firing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business), finds that most East Asian countries and four South Asian countries (Bangladesh, Nepal, Pakistan, and Sri Lanka) rank above average. However, Cambodia, China, Indonesia, the Philippines, and Viet Nam in East Asia, and Afghanistan, Bhutan, and India in South Asia rank below average. **Table 15** shows the rankings for various Asian countries.

Table 15
Ease of Doing Business Index:
Rankings for Asian Countries, 2005

Country	Ranking
Singapore	2
Hong Kong, China	7
Japan	10
Thailand	20
Malaysia	21
Korea, Republic of	27
Taipei,China	35
Nepal	55
Pakistan	60
Bangladesh	65
Sri Lanka	75
PRC	91
Viet Nam	99
Bhutan	104
Philippines	113
Indonesia	115
India	116
Afghanistan	122
Cambodia	133

Source: World Bank and IFC (2006).

Third, South and East Asian countries need to consolidate their FTAs. There are positive and negative economic aspects to the spread of FTAs in Asia. On the positive side, against a backdrop of slow progress in global trade talks, FTAs can promote continuing liberalization, induce structural reforms in the countries concerned, and widen market access across the region. Trade arrangements with dynamic, internationally competitive partners can also encourage the spread of efficient production practices.

On the negative side, however, the formation of a large number of bilateral FTAs can lead to the "spaghetti bowl effect."[10] FTAs can lead to trade diversion, with bilateral FTAs being the most trade-diverting. There can be harmful effects caused by multiple rules of origin (e.g., value-added rules or changes in customs classification) arising from overlapping

[10] For a concise restatement, see Bhagwati (2002).

agreements among members of different FTAs. Complex rules increase administrative and business costs, particularly for small and medium enterprises, which have limited capacity to deal with them. Such rules can also deter FDI and trade. Furthermore, the demands of negotiating multiple trade agreements place increasing strains on the scarce trade negotiation resources of many Asian countries, particularly the least-developed countries, which have limited trade policy capacity.

To make the proliferation of FTAs between South Asia and East Asia stepping-stones rather than stumbling blocks to multilateralism, policy makers in the region may wish to adopt the concept of "open regionalism" and broaden (create as large and as wide a market as possible) and deepen FTAs (extend coverage beyond trade in goods into services, investment, technology, etc.), to reduce the spaghetti-bowl effects mentioned above. Quantitative estimates using the computable general equilibrium (CGE) model and the Global Trade Analysis Project (GTAP) database suggest that a broader regional approach will have large beneficial impact. The estimated impact on national income of an ASEAN+3 and South Asia FTA is much higher than that of an ASEAN+3 and India FTA, which in turn is higher than that of an ASEAN FTA. While India benefits from an ASEAN+3 and India FTA, other South Asian countries lose. However, a broader ASEAN+3 and South Asian FTA is a win-win for all. This suggests that other South Asian countries should also join India in its "Look East" policy (Francois, Rana, Wignaraja, forthcoming).

The fourth measure that could significantly affect the level of trade between South Asia and East Asia is the reduction of trading costs. This could be brought about through investment in trade-related infrastructure and streamlining of cross-border procedures (including customs procedures and logistic costs). In the case of manufactured goods, trading costs could be the single highest cost of trading in developing countries—even higher than the costs of tariffs imposed by importers on their imports. A detailed analysis of these issues is beyond the scope of this paper, but several observations can be made.

- First, most cargo between South Asia and East Asia moves by water and air, as no land transport services are operating at present. The international shipping lines serving the South Asia–East Asia region operate on the equatorial route connecting East Asia and the Persian Gulf and Mediterranean. They call at the major transshipment hubs of Singapore and Colombo and use feeder vessels to collect cargo from, or distribute it to, the other ports in the region. Some ships call at the secondary hubs, e.g., Port Kelang, Nhava Sheva, but these are relatively few. There are also regional shipping services, but most use the same hubs to

construct back-to-back feeder services, one serving the Bay of Bengal and the other the Gulf of Thailand (**figure 7a**). There is a need to develop regional shipping lines so that ships call at various regional ports.

- Second, unlike the other corridors, the air corridor does not have fixed routes but is made up of a series of point-to-point connections. However, the airlines have generally adopted a hub-and-spoke arrangement for both passenger and freight operations. The international freight hubs are used for transshipment of cargoes moving between Europe, the Middle East, Southeast Asia, and East Asia. From there, there are routes connecting the hubs to the major airports and then to the local airports. Most of the transshipment hubs have developed because of the strength of the national carriers as well as demands of the local market. Thus Paris acts as a hub because of Air France's freight operation, Frankfurt because of Lufthansa's operations, Dubai because of Emirates, Singapore because of Singapore Airlines, and Seoul for Korean Airlines. The major exception is Bangkok, which has developed despite the fact that Thai Airways does not have a freighter operation. South Asia has yet to develop a regional transshipment hub, in part because of the lack of a national carrier with a strong freight operation and in part because of the lack of suitable airport facilities (**figure 7b**).
- Third, land transit through the Northeast Indian states and Myanmar is not yet possible and movements through Bangladesh are difficult because of restrictions on cross-border movements as well the condition of the road network (**figure 7c**). This will, however, eventually change as the volume of South Asia–East Asia trade increases. Additional corridors will have to be developed between India and China through Bhutan and Nepal. Recently, the Nathu La pass between China and India, which had been closed since 1962, was opened. This pass is 460 kilometers from Lhasa in Tibet and 550 kilometers from Calcutta, India's second-largest city. Land access to ports is also important in the case of landlocked countries.
- Fourth, the Trans-Asian Railways, although being built, is less developed than the Asian highway (**figure 7d**). The Qinghai–Tibet railway has been completed. There are plans to extend this line to Shigaste and to Yadong, a border town near India. A railway from Shigaste to Nilamu, a land port entry to Nepal is also to be built. Unlike roads, which are built to different standards but can all accommodate the same trucks, the railroad requires a common gauge. By 2015, it should be possible to travel by rail from Singapore to Kunming in China. However, between East Asia and South Asia, not only are there missing sections connecting

India/Bangladesh with Myanmar and then through to Thailand, but there are also different rail gauges. While India is standardizing its broad-gauge system, Southeast Asia remains meter-gauge and China, standard-gauge.

Figure 7a
Infrastructure: Southern Corridor—Shipping

Figure 7b
Infrastructure: Central Corridor—Air Freight Hubs

Figure 7c
Infrastructure: Northern Corridor—Asian Highway

Figure 7d
Infrastructure: Northern Corridor—Trans-Asian Railways

- Fifth, in the area of trade facilitation, countries should also make efforts to streamline cross-border procedures. These include delays in customs inspection, cargo handling and logistics, and processing of documents. Customs procedures could be modernized by aligning the customs code to international standards, simplifying and harmonizing procedures, making tariff structures consistent with the international harmonized tariff classification, and adopting and implementing the WTO Customs Valuation Agreement. The World Bank and the International Finance Corporation (IFC) (2006) estimate that the time now needed to complete the processing of import documents at the pre-shipment and arrival stage averages 47 days in South Asia and 28 days in East Asia. In the OECD, it is only 14 days. As Singapore's experience shows, electronic document filing could reduce logistic costs greatly. Within 2 years of the introduction of Singapore's TradeNet system, the time for cargo clearance was cut from 4 days to 30 minutes.
- Finally, trade promotion efforts through skillful economic diplomacy, regular exchange of business delegations, and civil society could be encouraged much more. People-to-people contacts can go a long way toward enhancing the level of trade and investment across countries.

References

Asher, M. G., and R. Sen. 2005. India-East Asia Integration: A Win-Win for Asia. Research and Information System for the Non-Aligned and Other Developing Countries (RIS), Discussion Paper No. 91/2005.

Asian Development Bank. 2005. A Study on Economic Cooperation between East Asia and South Asia. Technical Assistance Project No. 39592.

Bhagwati, J. 2002. *Free Trade Today*. Princeton University Press.

Chanda, N., When Asia was One. *Global Asia (undated).*

Chandra, Ramesh and Rajiv Kumar. 2008. South Asian Integration Prospects and Lessons from East Asia. Indian Council for Research in International Economic Relations.

Francois, Joseph, Pradumna B. Rana, and Ganeshan Wignaraja, eds. Forthcoming. *Pan-Asian Integration*, Chapter 1. Palgrave Macmillan.

Hiau Looi Kee, A. Nicita, and M. Olarreaga. 2006. Estimating Trade Restrictiveness Indices. World Bank Working Paper No. 3840. Washington, DC.

International Monetary Fund (IMF). 2006. *Balance of Payments Statistics*. CD-ROM, April.

———. 2007. *Balance of Payments Statistics*. CD-ROM, July.

———. 2007. *Direction of Trade Statistics*. CD-ROM, June.

Kumar, N., R. Sen, and M. G. Asher, eds. 2006. *India-ASEAN Economic Relations: Meeting the Challenges of Globalization*. ISEAS and RIS.

Mishap, P.P., India-Southeast Asian Relations: An Overview, *Teaching South Asia*. Vol.1, No. 1. 2001

Shankar, Vineeta. 2004. “Towards an Asian Economic Community: Exploring the Past” in Nagesh Kumar (ed), Towards and Asian Economic Community: Vision of a New Asia, RIS and ISEAS, 2004.

Sen, R., M. Asher, and R. S. Rajan. 2004. ASEAN-India Economic Relations: Current Status and Future Prospects. RIS, Discussion Paper No. 73/2004.

World Bank and International Finance Corporation (IFC). 2006. *Doing Business in 2006: Creating Jobs*. World Bank and IFC.

Appendix 1
Annotated List of Free Trade Agreements (FTAs) between South Asia and East Asia

FTA SIGNED AND UNDER IMPLEMENTATION

- India-Singapore Comprehensive Economic Cooperation Agreement (CECA)
  - Under CECA (signed June 2005 and effective August 2005), India will remove duties on 506 products from Singapore immediately, on 2,202 items by April 2009, and cut duties on another 2,407 products to 50% by the same date
  - Singapore will scrap tariffs on goods made in India starting 1 August 2005
  - The pact also covers services, investments, and cooperation in technology, education, air services, and human resources

- Asia-Pacific Trade Agreement (APTA, formerly Bangkok Agreement)
  - FTA under implementation since 1976

FRAMEWORK AGREEMENT SIGNED AND FTA UNDER NEGOTIATION

- ASEAN-India Regional Trade and Investment Area
  - Agreement signed October 2003 and became effective July 2004
  - Reduction or elimination of tariffs will start January 2006
  - India and ASEAN-6, excluding the Philippines, have until 2011 to reduce or eliminate tariffs
  - Between India and Philippines, the schedule runs to 2016
  - For India and new ASEAN members, India will reduce or eliminate tariffs before January 2011, while new ASEAN members will reduce or eliminate tariffs before 2016
  - Criteria for rules of origin remain to be resolved

- India-Thailand Free Trade Area
  - The Framework Agreement for the India-Thailand FTA (signed October 2003 and effective September 2004) reduces tariffs on 82 “early harvest” items by 50% in the first year, by 75% in the second year, and 100% thereafter
  - The second phase hopes to have a comprehensive FTA covering all items by 2010.
  - Agreement provides for emergency measures to protect domestic producers in case of sudden surges in imports
- BIMSTEC Free Trade Area
  - The Framework Agreement on the BIMSTEC FTA (signed in February 2004 and effective June 2004) involves a reduction and elimination of

tariffs starting July 2006 up to 2010 for India, Sri Lanka, and Thailand and up to 2017 for Bhutan, Myanmar, and Nepal
    - Negotiations began in September 2004
    - FTA will have two phases (for fast-track and normal-track products)
    - Members were scheduled to provide their sensitive lists to the trade negotiating committee meeting in June 2005

- PRC-Pakistan Free Trade Agreement
    - In December 2004, a Joint Study Group was formed to study the feasibility of the Pakistan-PRC FTA
    - A Memorandum of Understanding on FTA and Other Trade Issues was signed in April 2005 announcing the conclusion of the Joint Feasibility Study on Pakistan-PRC FTA and launching of negotiations on the FTA
    - The Agreement on Early Harvest Program (EHP) was also signed
    - EHP includes a common list of items whose tariffs will be removed and a separate list for each country whose duties will also be scrapped

- India–Republic of Korea Comprehensive Economic Partnership Agreement (CEPA)
    - A Joint Study Group was set up on 6 October 2004 and its concluding report was signed on January 2006. It recommended that a comprehensive economic partnership agreement (CEPA) exploit the existing bilateral economic relations between the two countries and provide significant benefits for both
    - Following the recommendations of the Joint Study Group, a Joint Task Force composed of government officials of both countries was constituted for the development of the CEPA
    - FTA negotiation launched in March 2006

- Malaysia-Pakistan Free Trade Agreement
    - FTA negotiation launched February 2005
    - Early Harvest Program (EHP) signed October 2005 for implementation January 2006

- Pakistan-Singapore Free Trade Agreement
    - FTA negotiation launched August 2005

- Pakistan-Indonesia Free Trade Agreement
    - On November 2005, Pakistan and Indonesia signed the Framework Agreement on Comprehensive Economic Partnership and expressed willingness to conclude an FTA
    - Both parties decided to negotiate a preferential trade agreement and move toward the goal of an FTA.

FTAs PROPOSED

- China-India Regional Trading Arrangement
  - In June 2003, India and China agreed to set up a Joint Study Group (JSG). The JSG was tasked to present a report and recommendation on comprehensive trade and economic cooperation
  - In March 2005, the report of the JSG was finalized. It recommended a China-India Regional Trading Arrangement, which shall cover trade in goods and services, and investments

- Japan-India Economic Partnership Agreement
  - On 29 November 2004, Japan and India agreed to establish a Japan-India Joint Study Group (JSG) for a Comprehensive Study to serve as a framework for reviewing their economic relationship
  - On 29 April 2005, both parties directed the JSG to submit a report within a year, focusing on requirements for a comprehensive expansion of trade in goods and services, investment flows, and other areas of economic cooperation

  - FTA proposed August 2005

- Malaysia-India Comprehensive Economic Cooperation Agreement
  - FTA proposed January 2005

- Pakistan-Philippines Free Trade Agreement
  - FTA proposed 2004

- Pakistan-Thailand Free Trade Agreement
  - FTA proposed April 2004

- Singapore–Sri Lanka Comprehensive Economic Partnership Agreement
  - FTA proposed October 2003

Sources: Asia Regional Integration Center website, aric.adb.org.