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# Strengthening Economic Linkages between South Asia and East Asia: The Case for a Second Round of "Look East" Policies

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# ABSTRACT

This paper argues that South Asian countries need to embark on a second round of "Look East" Policies (LEP2) to (i) link themselves to production networks in East Asia and (ii) develop production networks in manufacturing and services within their region. Such policies would allow both regions to benefit mutually and in a shared manner not only from the static complementarities of the Hecksher-Ohlin type but also the dynamic complementarities based on augmented product fragmentation and new geography theories proposed by Jones and Kierzkowski (1990) and Kimura and Mitsuyo (2005). As in East Asia, economic integration between these two regions would increase and a virtuous cycle would be established between integration, economic growth and welfare. LEP2 would also poise South Asia to benefit from the gradual but encouraging opening of Myanmar, a node for South Asia–East Asia relations and connectivity. The key components of LEP2 in South Asia should comprise (i) completing the economic reform process that began in the early 1990s by focusing on the remaining microeconomic reforms (ii) lobbying and negotiating to participate in various on-going regional trade and financial cooperation efforts in East Asia (iii) creating a trade-friendly environment "at the border" and "behind the border" and (iv) improving "beyond the border" connectivity and logistics with East Asia to reduce trading costs between the two regions.

**Keywords:** regional economic integration, production networks, South Asia, East Asia, international trade, foreign direct investment.

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support for Asian economic integration. He obtained his PhD from Vanderbilt University, where he was a Fulbright Scholar and a Masters in Economics from Michigan State University and Tribhuvan University. He has authored/edited 15 books, and published over 50 articles in international scholarly journals. Most recently, he edited a book entitled The Renaissance of Asia: Evolving Economic Relations between South Asia and East Asia (World Scientific Publishers). He also co-edited books on Pan-Asian Integration: Linking East and South Asia (Palgrave Macmillan) and National Strategies for Regional Integration: South and East Asian Case Studies (Anthem Press, UK).

Asst Prof Chia Wai Mun obtained her Bachelor's degree in Economics from the University of London with First Class Honours in 1996. She was then awarded the Datuk Paduka Hajjah Saleha Ali Academic Outstanding Award for her exceptional academic performance at international level in 1997. In 1998, with the support of the London School of Economics (LSE) Scholarship, she pursued her Master's degree at LSE. In 2006, she graduated with a PhD degree from NTU. She is currently Assistant Professor at the Division of Economics, NTU. Prior to joining NTU, she was an industry analyst at the Federation of Malaysian Manufacturers. Her current research interests are international macroeconomics, economic integration in East Asia and cost-benefit analysis. She is an assistor editor to the Singapore Economic Review. She is also a research consultant to the ASEAN Secretariat. She has published widely in internationally reputable journals such as the World Economy, Economic Record and Journal of Economic Dynamics and Control.

# Strengthening Economic Linkages between South Asia and East Asia: The Case for a Second Round of "Look East" Policies[1]

## I. Introduction

South Asian countries[2] initiated their "Look East" Policies to enhance closer relations with East Asia as part of their economic reform programs in the early 1990s. India announced its "Look East" Policies in 1991 and other countries followed suit in a more informal manner. These policies have had many positive impacts. A number of free trade agreements (FTAs) have been signed between South Asia and East Asia[3], India holds summit-level dialogues with ASEAN and is a member of the East Asia Summit (Section II). India is also negotiating the Regional Comprehensive Economic Partnership (RCEP) which is a FTA among ASEAN and its six dialogue partners - Australia, China, India, Japan, Korea, and New Zealand. Trade between South Asia and East Asia has surged during the past decade and China has become India's largest trading partner. Economic growth has also improved and reached a higher trajectory. But now, however, economic growth is slowing quite sharply. For example, the Indian economy which grew by 8-9 percent during 2009-2010, slowed to 6 percent during 2011-2012, and is now witnessing reduced growth at around 5 percent per annum. Economic integration in the region – which was much higher in the past - has been dormant for over six decades.

South Asian countries, therefore, need to embark on the second round of their "Look East" Policies (LEP2) to (i) link themselves to production networks in East Asia and (ii) develop production networks in manufacturing and services within their region. Such policies would allow both regions to benefit mutually not only from static complementarities of the Hecksher-Ohlin type but also dynamic complementarities based on augmented product fragmentation and new geography theories proposed by Jones and Kierzkowski (1990) and Kimura and Mitsuyo (2005). As in East Asia, economic integration between the two regions would increase and a virtuous cycle would be established between integration, economic growth and welfare. LEP2 would also poise South asia to benefit from the gradual but encouraging opening up of Myanmar which is a node for South Asia-East Asia relations and

1 Research support from the Academic Research Fund of NTU is gratefully acknowledged.

2 Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka

3 Defined as ASEAN+3 (China, Korea, Japan)

connectivity. Conflicts in the South China Sea have also played a catalytic role in deepening ASEAN-India relations.

LEP2 would be a win-win situation for all countries in South Asia and East Asia and enhance their integration and economic dynamism. It will also contribute to the re-emergence of a "prosperous and integrated" Asia which had existed during the first 18 centuries of the post-Christian era (Rana 2012a). It would also help to reinvigorate economic integration in South Asia which has been dormant for a long time. This is the focus of the paper.

Before World War II, South Asia was a well integrated region of the British Empire. Then in 1947, Pakistan and India became independent. At that time more than half of Pakistan's imports came from India and nearly two thirds of its exports went to India. Similar trade relations existed between India and Sri Lanka, which was settled by immigrants from South India much earlier. Total trade volumes among the countries of the region were estimated at around 20 percent of total trade before partition in 1948 (World Bank 2004). After the partition of Pakistan, tensions between the two countries increased and bickering over water rights, territory and currency valuation impacted trade between Pakistan and India. In the 1950s and 1960s, all the countries in South Asia pursued import substitution strategies and eschewed export promotion. The level of intra-regional trade fell to about 4 per cent by the end of the 1950s and 2 per cent by 1967 (Rana and Dowling 2009).

The level of intraregional trade in South Asia began to increase only after the countries in the region abandoned important substitution policies and began to adopt trade liberalization measures in the 1990s. In recent years, the level of intraregional trade has increased to around 5 percent of total trade, still relatively low compared with trade in other developing regions in Asia and the rest of the world, making it one of the least sub-regions of the world (Rana and Dowling 2009).

The reason for lower levels of intra-regional trade in South Asia is not the lack of official institutional arrangements to promote regional cooperation. Just like the ASEAN, South Asia has the South Asia Association for Regional Cooperation (SAARC). In the area of trade, the SAARC has the South Asian Preferential Trading Agreement (SAPTA) which subsequently became the South Asian Free Trade Agreement (SAFTA). In the area of money and finance, they have the SAARCFINANCE and proposals for an economic and monetary union in South Asia are being discussed. In the area of connectivity, they have the South Asian Growth Quadrangle and South Asian Sub-regional Economic Cooperation (SASEC).

There are many reasons for the low level of integration in South Asia. The most obvious ones are the hostility between India and Pakistan and other countries and India's failure to promote greater stability in the region through regional cooperation (see, for example, Rana MSJBR 2012). India prefers bilateral negotiations rather than multilateral ones. This political impasse has no easy solution and the recent "step by step" improvements in India-Pakistan relations could reverse quickly. While East Asian countries have pushed ahead with the regional cooperation agenda despite political conflicts[4], in South Asia, conflicts have become serious stumbling blocs and have suffocated integration efforts. Since a "direct" approach to promoting integration through regional cooperation policies in South Asia has not worked well (with perhaps the exception of the India-Sri Lanka free trade agreement (FTA)), this paper makes the case for an "indirect" approach. The "indirect" approach comprises implementing the second round of "Look East" Policies by South Asia.

In the above context, this paper will (i) review trends in economic linkages between South Asia and East Asia (ii) assess the potential for economic linkages between the two sub-regions using both the static complementary measures and the more dynamic measures focusing on the potential for vertical integration under the "augmented product fragmentation and new geography" theories developed by Jones and Kierzkowski (1990) and Kimura and Mitsuyo (2005) (iii) analyze the economic impacts of the "indirect" approach and (iv) outline the components of "Look East" Policies II to link South Asia to production networks in East Asia.

## II. Evolving Relations between South Asia and East Asia

India started to actively enhance its linkages with East Asia in 1991 when it announced its "Look East" Policy. Since then, other South Asian countries (most notably Pakistan but also others) have followed suit, although in a more informal manner without any formal announcement of such policies as such. 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 (Table 1). The first summit-level interaction began in November 2002. Since 2005, India has also participated in the East Asia

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[4] A case in point is that despite conflicts in South China Sea, East Asian countries have decided to initiate negotiations of the Regional Comprehensive Economic Partnership and the trilateral (China-Korea-Japan) FTA.

Summit that brings together the heads of states and governments of ASEAN+3 plus Australia, New Zealand, India, and more recently the US and Russia. Singapore has actively lobbied for India's engagement with East Asia. At the East Asia Summit in Singapore in 2007, it was decided to revive the 3000-year old Nalanda University in India as a Pan-Asian center of excellence. This year, Professor A.K. Sen was appointed as the Chancellor of Nalanda University. In 2010, ASEAN-India FTA became effective, and in December this year the 20$^{th}$ Commemorative ASEAN-India Summit is to be held.

**Table 1:** South Asia-East Asia Economic Relations: Some Landmarks

| Year | Details |
|---|---|
| **1975** | • Signing of Bangkok Agreement by Bangladesh, India, Laos, Korea, Sri Lanka and China. |
| **1985** | • Formation of the South Asian Association for Regional Cooperation (SAARC) by Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. Afghanistan joined in 2007. |
| **1991** | • India adopted "Look East" Policy to strengthen economic relationships with East Asian countries. |
| **1992** | • Signing of the Association of Southeast Asian Nations (ASEAN) Free Trade Area (AFTA) by Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand. Other Southeast Asian countries joined later: Vietnam (1995), Lao PDR and Myanmar (1997), and Cambodia (1999). AFTA became fully operational in 2003.<br>• India became a sectoral dialogue partner of ASEAN. |
| **1993** | • Signing of SAARC Preferential Trading Arrangement (SAPTA) by 8 SAARC members. SAPTA entered into force in 1997. |
| **1995** | • India became full dialogue partner of ASEAN. |
| **1996** | • India admitted to the ASEAN Regional Forum. |
| **1997** | • East Asian financial crisis. |
| **1998** | • Signing of Indo-Sri Lanka Free Trade Agreement which came into force in 2000. |
| **2000** | • China joined the World Trade Organisation (WTO), starting with an early harvest program that liberalised 600 farm products. An agreement to trade in goods was signed in 2005, liberalising 7,000 trading goods. |
| **2002** | • India-ASEAN partnership was upgraded to summit –level dialogue.<br>• Signing of Framework Agreement between China and ASEAN. Early Harvest Scheme came into force in 2005. |
| **2003** | • Signing of a Framework Agreement on Comprehensive Economic Cooperation between India and ASEAN, incorporating free trade agreement (FTA), at the Bali Summit. |
| **2004** | • Signing of Agreement on South Asian Free Trade Area (SAFTA) and came into force in 2006.<br>• Signing of a Long-Term Partnership for Peace, Progress and Shared Prosperity by India and ASEAN at the Laos PDR Summit.<br>• Signing of Early Harvest Scheme for the India-Thailand Free Trade Framework Agreement<br>• Signing of a Framework Agreement under the Bay of Bengal Initiative for |

| | |
|---|---|
| | Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) by Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, and Thailand. |
| **2005** | • East Asia Summit established<br>• Signing of a Comprehensive Economic Cooperation Agreement (CECA) between India and Singapore.<br>• Renaming of the Bangkok Agreement as the Asia-Pacific Trade Agreement (APTA).<br>• Signing of a Comprehensive Economic Framework Agreement between Pakistan and Indonesia. |
| **2006** | • China became an observer of SAARC. On-going Japanese proposal for a comprehensive agreement covering ASEAN+3, India, Australia, and New Zealand.<br>• Signing of an FTA between China and Pakistan. |
| **2007** | • Signing of Pakistan-Malaysia Free Trade Agreement-Pakistan's first comprehensive FTA and Malaysia's first bilateral FTA with a South Asian country.<br>• China-Pakistan FTA became effective. |
| **2008** | • Pakistan-Malaysia Closer Economic Partnership became effective. |
| **2009** | • Signing of the ASEAN-India FTA (in goods trade) in August 2009.<br>• Signing of the India-Korea Comprehensive Economic Partnership Agreement in August 2009. |
| **2010** | • Comprehensive Asia Development Plan (CADP) submitted by ERIA to EAS<br>• Master plan on ASEAN Connectivity approved.<br>• ASEAN-India FTA (in goods trade) became effective in January 2010.<br>• India-Korea Comprehensive Economic Partnership Agreement (CEPA) became effective. |
| **2011** | • ASEAN-India connectivity selected as main theme of CADPII.<br>• Signing of Malaysia-India Comprehensive Economic Cooperation Agreement (CECA)<br>• Japan-India Comprehensive Economic Partnership Agreement (CEPA) was signed in January and came into effect in August 2011. |
| **2012** | • Prof Sen appointed Chancellor of Nalanda University.<br>• 20th Commemorative Summit to be held 20/21 December.<br>• Pakistan-Indonesia FTA signed in February 2012. |

As in other parts of the world, there has also been a proliferation of FTAs between South Asia and East Asia. In 1975, the only active FTA in the region was the Bangkok Agreement. Now nine FTAs are already in effect and another thirteen are either under negotiation or have been proposed (Table 2). The most significant of these, so far, is the signing of the India-Singapore Comprehensive Economic Cooperation Agreement (CECA) in June 2005. The CECA became effective in August 2005 and covers not only trade in goods but also services, investments and cooperation in technology, education, air services and human resources. The Asia Pacific Trade Agreement went into effect in 1976, the Group of 8 FTA in 2006, the China-Pakistan FTA in 2007 and the Malaysia-Pakistan FTA – Malaysia's first with a South

Asian country - in 2008. In 2010, the ASEAN-India CECA (in trade in goods) went into effect. Although comprehensive in terms of trade liberalization, the CECA allows India to protect its agriculture and services sector for some time. In the same year, India-Korea Comprehensive Economic Partnership Agreement (CEPA) also became effective. Last year, the Japan-India CEPA, and Malaysia-India CECA went into effect.

**Table 2:** FTAs Involving South and East Asian Countries

**FTAs in Effect**

- Asia-Pacific Trade Agreement (APTA) signed in 1975 and in effect since 1976.
- India-Singapore Comprehensive Economic Cooperation Agreement (CECA), signed in June 2005 and in effect since August 2005.
- Preferential Tariff Arrangement-Group of Eight Developing Countries (D-8 PTA)[5], signed in 2006.
- China-Pakistan Free Trade Agreement signed on 24 November 2006 and in effect since July 2007.
- Malaysia-Pakistan Closer Economic Partnership, signed in November 2007 and in effect since January 2008.
- Association of Southeast Asian Nations (ASEAN)-India Comprehensive Economic Cooperation Agreement (CECA) (trade in goods), signed in August 2009 and in effect since January 2010.
- India-Korea Comprehensive Economic Partnership Agreement (CEPA), signed in August 2009 and in effect since January 2010.
- Japan-India Comprehensive Economic Partnership Agreement (CEPA), signed in January 2011 and in effect since August 2011.
- Malaysia-India Comprehensive Economic Cooperation Agreement (CECA), signed in February 2011 and in effect since July 2011.

**FTAs Signed but not yet in Effect**

- Pakistan-Indonesia Free Trade Agreement signed in February 2012.

**FTAs under Negotiation**

- India-Indonesia Comprehensive Economic Cooperation Arrangement.
- Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation. (BIMSTEC) Free Trade Area.[6]
- India-Thailand Free Trade Area.
  Trade Preferential System of the Organization of the Islamic Conference (TPS-OIC).

**Proposed FTAs**

- ASEAN-Pakistan Free Trade Agreement.
- Comprehensive Economic Partnership Agreement between Singapore and Sri Lanka.
- Comprehensive Economic Partnership for East Asia (CEPEA/ASEAN+6).[7]
- Pakistan-Brunei Darussalam Free Trade Agreement.
- Pakistan-Philippines Free Trade Agreement.
- Pakistan-Singapore Free Trade Agreement.
- Pakistan-Thailand Free Trade Agreement.
- China-India Regional Trading Arrangement.

Source: ADB FTA Database (www.aric.adb.org)

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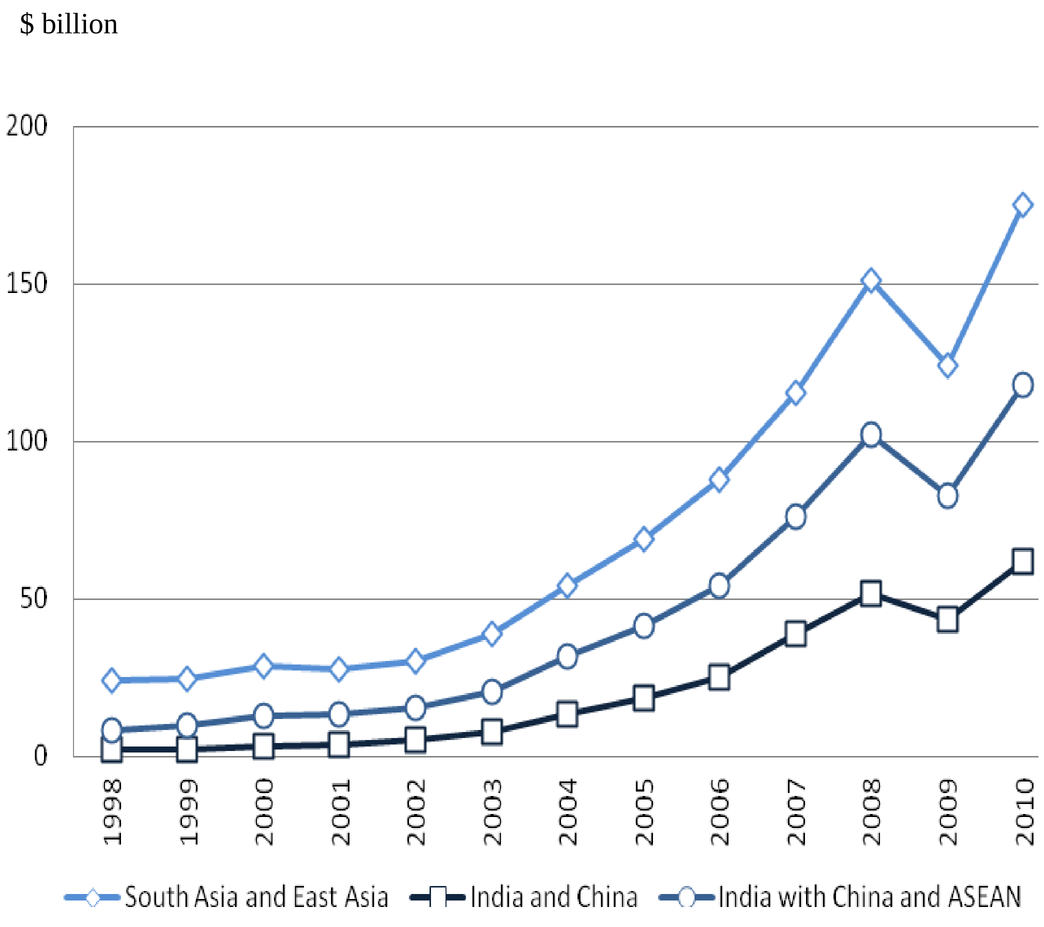
5 D-8 PTA members are Bangladesh, Egypt, Iran, Malaysia, Nigeria, Pakistan, Indonesia, and Turkey.

6 BIMSTEC members are Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, and Thailand

7 CEPEA/ASEAN+6 members are Australia, New Zealand, Japan, India, China, Republic of Korea, Brunei Darussalam, Cambodia, Indonesia, Lao, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

## III. Economic Linkages between South Asia and East Asia

South Asia's total merchandise trade (exports plus imports) with East Asia has grown significantly in absolute terms albeit from a low base (Figure 1). It increased seven-fold during the period - 1998 to 2010, from $24.1 billion to $175 billion. The annual growth rate was relatively moderate until 2002 but it has surged after that except in 2009 when it dipped because of the global economic crisis. As expected, the two largest components of this trade are the bilateral trade between the two "giant" economies of India and China, and the trade between India and ASEAN: The former has overtaken the latter since 2009. There are, however, a number of issues that should be taken into consideration (i) India accounts for the largest share of South Asia and East Asia trade with Pakistan a distinct second (Table 3) (ii) all South Asia countries have trade imbalance with East Asia (Table 3) (iii) East Asia is more important to South Asia than vice versa (Figures 2 and 3) and (iv) South Asia exports mainly primary products to East Asia and imports mostly manufactured goods.




Source: CEIC

**Figure 1:** Total trade between South Asia and East Asia, 1998-2010

**Table 3:** Value of merchandise trade between East Asia and South Asia, $Mn

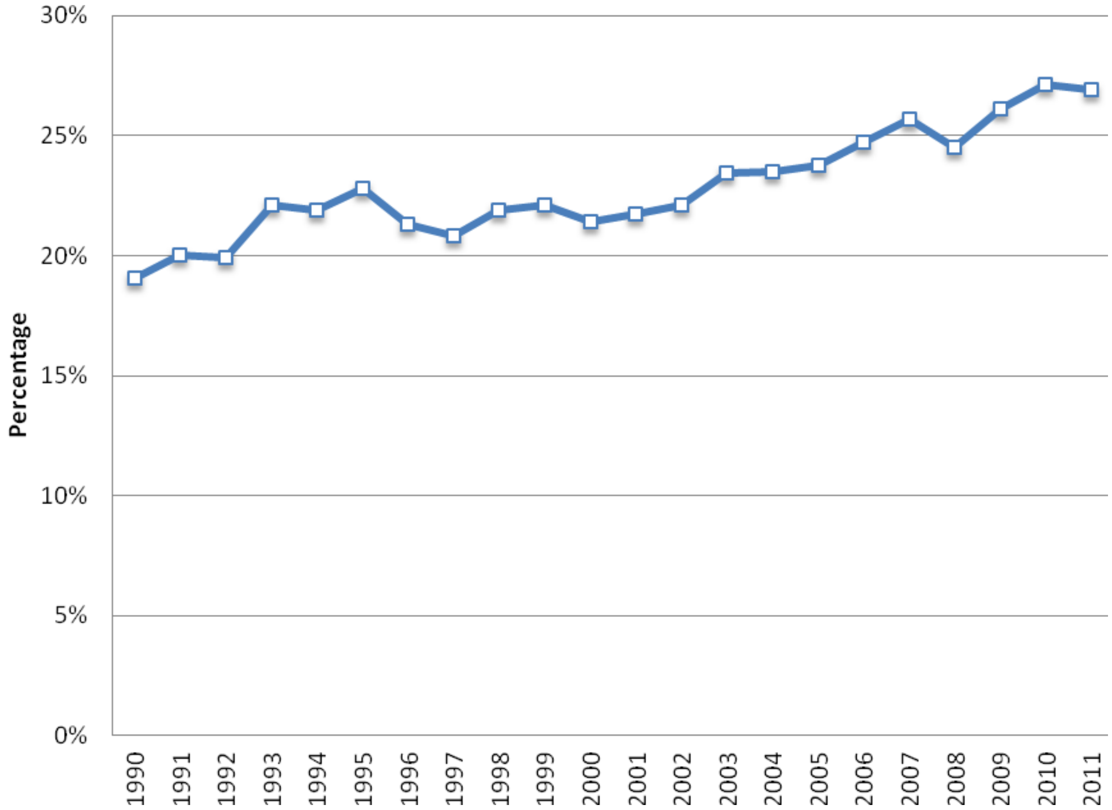
| | Exports | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | East Asia | | | | South Asia | | | |
| | **1990** | **2000** | **2005** | **2010** | **1990** | **2000** | **2005** | **2010** |
| **East Asia** | **282,256** | **799,170** | **1,185,847** | **1,988,905** | **10,559** | **25,575** | **53,380** | **145,610** |
| China | 40,956 | 121,031 | 298,935 | 546,272 | 950 | 3,775 | 15,961 | 57,607 |
| Japan | 86,154 | 195,315 | 238,240 | 367,005 | 3,482 | 4,096 | 6,034 | 12,179 |
| Korea | 22,861 | 78,752 | 128,906 | 223,503 | 1,115 | 2,756 | 6,154 | 14,134 |
| Brunei | 2,115 | 2,482 | | | | | | |
| Cambodia | 35 | 125 | 764 | 2,269 | 3 | 1 | 1 | 26 |
| Indonesia | 17,217 | 36,954 | 49,114 | 89,898 | 199 | 1,742 | 4,243 | 12,017 |
| Lao | 54 | 188 | | | | | | |
| Malaysia | 17,086 | 54,877 | 72,560 | 113,807 | 870 | 2,765 | 5,662 | 10,712 |
| Myanmar | 217 | 729 | | 6,164 | 63 | 202 | | 1,061 |
| Philippines | 3,075 | 18,928 | 23,165 | 31,690 | 7 | 97 | 150 | 542 |
| Singapore | 23,219 | 74,322 | 133,792 | 214,969 | 2,154 | 4,696 | 8,151 | 17,753 |
| Thailand | 8,867 | 33,817 | 56,510 | 102,965 | 280 | 1,201 | 2,819 | 6,810 |
| Vietnam | 1,022 | 7,868 | 14,347 | 30,392 | 20 | 84 | 186 | 1,446 |
| **South Asia** | **5,184** | **11,389** | **28,661** | **62,388** | **882** | **2,736** | **8,375** | **15,813** |
| Afghanistan | 3 | 9 | | 13 | 19 | 60 | | 217 |
| Bangladesh | 176 | 277 | 579 | | 61 | 88 | 274 | |
| India | 3,357 | 8,854 | 25,881 | 58,346 | 486 | 1,792 | 5,400 | 11,114 |
| Maldives | 17 | 14 | 58 | 25 | 7 | 14 | 20 | 17 |
| Nepal | 15 | 22 | | 34 | 16 | 309 | | 616 |
| Pakistan | 1,403 | 1,703 | 1,726 | 3,038 | 223 | 282 | 1,797 | 2,885 |
| Sri Lanka | 213 | 510 | 400 | 880 | 70 | 190 | 644 | 603 |

**Table 3:** Value of merchandise trade between East Asia and South Asia, $Mn (Continued)

| | Imports | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | East Asia | | | | South Asia | | | |
| | **1990** | **2000** | **2005** | **2010** | **1990** | **2000** | **2005** | **2010** |
| **East Asia** | **283,951** | **796,806** | **1,183,818** | **1,915,378** | **6,747** | **14,592** | **31,441** | **67,039** |
| China | 25,590 | 100,558 | 319,610 | 588,881 | 213 | 1,881 | 10,725 | 22,964 |
| Japan | 64,294 | 153,423 | 207,050 | 283,918 | 2,825 | 3,260 | 3,700 | 6,630 |
| Korea | 25,491 | 67,969 | 115,158 | 181,914 | 482 | 1,331 | 2,512 | 6,272 |
| Brunei | 616 | 998 | | | 1 | 6 | | |
| Cambodia | 34 | 1,254 | 1,918 | 3,828 | 2 | 11 | 28 | 75 |
| Indonesia | 10,476 | 18,064 | 33,239 | 85,991 | 290 | 676 | 1,141 | 3,508 |
| Lao | 130 | 613 | | | | 7 | | |
| Malaysia | 15,583 | 49,850 | 67,422 | 98,924 | 261 | 800 | 1,190 | 2,740 |
| Myanmar | 454 | 2,754 | | 3,591 | 3 | 58 | | 182 |
| Philippines | 5,838 | 19,694 | 25,331 | 34,297 | 148 | 195 | 412 | 808 |
| Singapore | 30,652 | 77,376 | 104,676 | 153,683 | 550 | 1,275 | 4,274 | 9,469 |
| Thailand | 18,505 | 34,622 | 65,574 | 104,577 | 681 | 800 | 1,445 | 2,462 |
| Vietnam | 1,026 | 12,166 | 24,129 | 56,245 | 4 | 209 | 677 | 1,937 |
| **South Asia** | **9,892** | **21,598** | **47,558** | **117,476** | **825** | **3,285** | **5,702** | **11,251** |
| Afghanistan | 315 | 195 | | 1,399 | 70 | 169 | | 712 |
| Bangladesh | 1,566 | 4,169 | 5,570 | | 257 | 1,052 | 1,547 | |
| India | 4,168 | 10,396 | 30,991 | 96,849 | 97 | 428 | 1,380 | 2,064 |
| Maldives | 101 | 195 | 320 | 412 | 17 | 90 | 129 | 194 |
| Nepal | 336 | 502 | | 1,107 | 79 | 587 | | 2,938 |
| Pakistan | 2,192 | 2,884 | 7,278 | 12,382 | 122 | 252 | 765 | 1,827 |
| Sri Lanka | 1,214 | 3,256 | 3,347 | 5,191 | 184 | 707 | 1,585 | 2,858 |

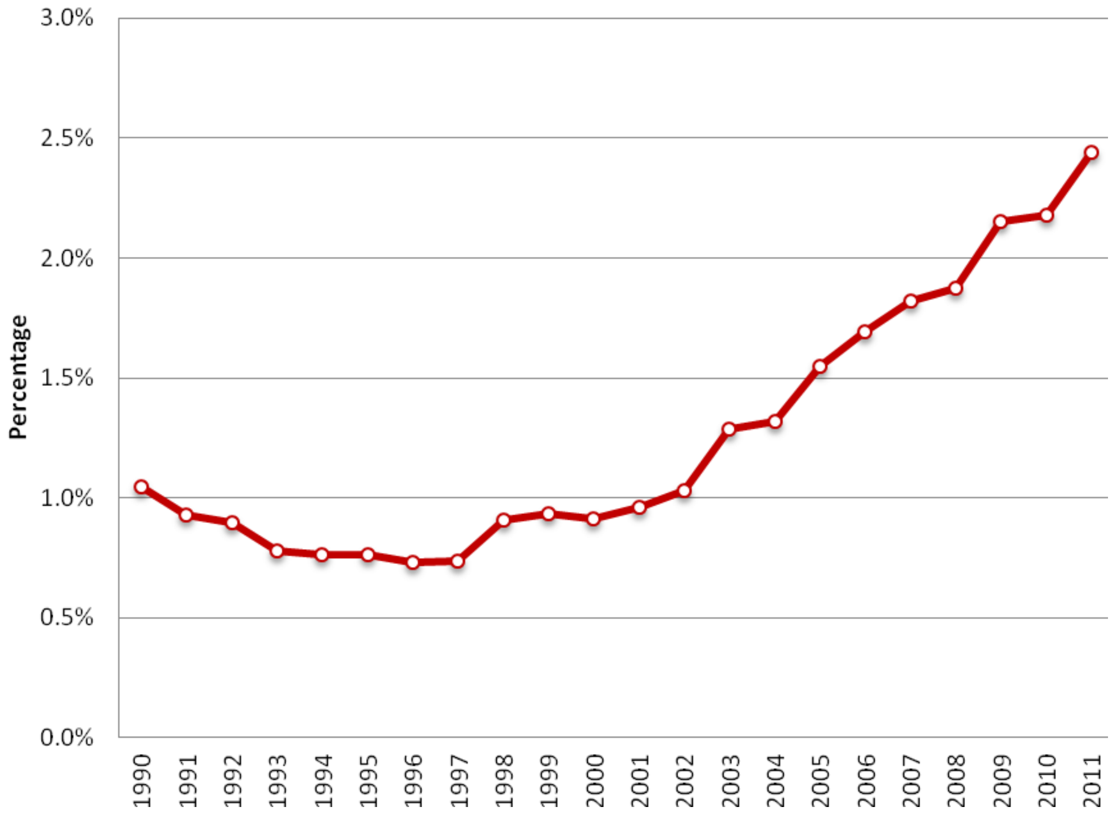
**Table 3:** Value of merchandise trade between East Asia and South Asia, $Mn (Continued)

| | Exports - Imports | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | East Asia | | | | South Asia | | | |
| | **1990** | **2000** | **2005** | **2010** | **1990** | **2000** | **2005** | **2010** |
| **East Asia** | **(1,695)** | **2,364** | **2,029** | **73,527** | **3,812** | **10,983** | **21,939** | **78,571** |
| China | 15,366 | 20,473 | (20,675) | (42,609) | 737 | 1,894 | 5,236 | 34,644 |
| Japan | 21,860 | 41,892 | 31,189 | 83,088 | 657 | 836 | 2,334 | 5,548 |
| Korea | (2,630) | 10,783 | 13,748 | 41,590 | 633 | 1,425 | 3,642 | 7,861 |
| Brunei | 1,499 | 1,484 | | | 0 | (2) | | |
| Cambodia | 1 | (1,129) | (1,154) | (1,560) | 1 | (10) | (27) | (49) |
| Indonesia | 6,741 | 18,890 | 15,876 | 3,907 | (91) | 1,066 | 3,102 | 8,508 |
| Lao | (76) | (425) | | | | | | |
| Malaysia | 1,503 | 5,027 | 5,138 | 14,883 | 609 | 1,965 | 4,472 | 7,973 |
| Myanmar | (237) | (2,025) | | 2,573 | 60 | 144 | | 878 |
| Philippines | (2,763) | (766) | (2,166) | (2,607) | (141) | (98) | (262) | (266) |
| Singapore | (7,433) | (3,054) | 29,116 | 61,286 | 1,604 | 3,421 | 3,877 | 8,284 |
| Thailand | (9,638) | (805) | (9,064) | 1,613) | (401) | 401 | 1,374 | 4,348 |
| Vietnam | (4) | (4,298) | (9,782) | (25,854) | 16 | (125) | (491) | (491) |
| **South Asia** | **(4,708)** | **(10,209)** | **(18,897)** | **(55,089)** | **57** | **(549)** | **2,673** | **4,563** |
| Afghanistan | (312) | (186) | | (1,386) | (51) | (109) | | (495) |
| Bangladesh | (1,390) | (3,892) | (4,991) | | (196) | (964) | (1,273) | |
| India | (811) | (1,542) | (5,111) | (38,503) | 389 | 1,364 | 4,020 | 9,050 |
| Maldives | (84) | (181) | (262) | (386) | (10) | (76) | (109) | (177) |
| Nepal | (321) | (480) | | (1,073) | (63) | (278) | | (2,322) |
| Pakistan | (789) | (1,181) | (5,552) | (9,344) | 101 | 30 | 1,032 | 1,058 |
| Sri Lanka | (1,001) | (2,746) | (2,948) | (4,311) | (114) | (517) | (941) | (2,255) |




Source: CEIC

**Figure 2:** Total trade between South Asia and East Asia (as a percentage of South Asia's total trade with the world), 1990-2011




Source: CEIC

**Figure 3:** Total trade between South Asia and East Asia (as a percentage of East Asia's total trade with the world), 1990-2011

In terms of FDI, although inflows into South Asia (especially to India) have been increasing, in 2010, they were only one-tenth of the inflows into East Asia (Table 4). The absence of comparable data on FDI by source limits an analysis of investment relationships between South Asia and East Asia. Those available from national sources suggest that East Asian countries are starting to become important sources of FDI for South Asia countries (Table 5). China, Malaysia, and Thailand are joining traditional high income countries such as Hong Kong, Korea, Japan and Singapore as "source" countries for FDI in South Asia. China is the third largest source of FDI for Sri Lanka and the sixth largest source for Pakistan. Similarly, Malaysia is the largest source for Sri Lanka, and Singapore is second-ranked FDI source for India - 1500 Indian companies are currently based in Singapore and the number of airline flights from Singapore to various Indian cities have increased greatly. Automobile industry in India is benefitting from FDI from Korea and Japan: Electronics in India is also benefitting from FDI from Korea, Taiwan, and Singapore: Infrastructure in India and other South Asian countries is also benefitting from FDI from China, Malaysia and Singapore.

**Table 4:** World FDI inflows into South Asia and East Asia ($Mn)

| | **1990** | **1995** | **2000** | **2005** | **2010** |
|---|---|---|---|---|---|
| **South Asia** | **567.55** | **2800.40** | **4648.10** | **10942.48** | **27658.84** |
| Bangladesh | 3.24 | 92.30 | 578.64 | 845.26 | 913.30 |
| India | 236.69 | 2151.00 | 3587.99 | 7621.77 | 24159.20 |
| Nepal | 5.94 | 0.00 | -0.48 | 2.45 | 86.74 |
| Pakistan | 278.33 | 492.10 | 309.00 | 2201.00 | 2022.00 |
| Sri Lanka | 43.35 | 65.00 | 172.95 | 272.00 | 477.60 |
| **East Asia** | **19583.03** | **72366.26** | **125348.82** | **140994.98** | **264765.54** |
| Brunei | 7.00 | 582.76 | 549.61 | 289.48 | 625.67 |
| Cambodia | 0.00 | 150.70 | 148.50 | 381.18 | 782.60 |
| China | 3487.11 | 37520.53 | 40714.81 | 72406.00 | 114734.00 |
| Hong Kong | 3275.07 | 6213.36 | 61937.94 | 33624.65 | 71069.50 |
| Indonesia | 1092.00 | 4419.00 | -4495.00 | NA | NA |
| Lao | 6.00 | 95.10 | 33.89 | 27.70 | 332.60 |
| Malaysia | 2611.00 | 5815.00 | 3787.63 | 4065.31 | 9102.97 |
| Myanmar | 225.10 | 317.60 | 208.00 | 235.80 | 450.20 |
| Philippines | 550.00 | 1459.00 | 2240.00 | 1854.00 | 1298.00 |
| Singapore | 5574.75 | 11942.81 | 15515.33 | 18090.30 | 48636.68 |
| Thailand | 2575.00 | 2070.00 | 3410.12 | 8066.55 | 9733.32 |
| Vietnam | 180.00 | 1780.40 | 1298.00 | 1954.00 | 8000.00 |

Source: UNCTAD, FDI Indicators Online.

**Table 5:** FDI inflows from East Asia

| | India (2008) | | Pakistan (2007) | | Bangladesh (2005) | | Sri Lanka (2008) | |
|---|---|---|---|---|---|---|---|---|
| | **Flow $ Mn** | **Rank** | **Flow $ Mn** | **Rank** | **Flow $ Mn** | **Rank** | **Flow $ Mn** | **Rank** |
| Cambodia | | | | | | | | |
| China | 50.5 | 35 | 101.4 | 6 | 0.9 | 21 | 101.2 | 3 |
| Hong Kong | 493.7 | 19 | 156.1 | 5 | 47.4 | 9 | | |
| Indonesia | 72.9 | 29 | | | 5.4 | 15 | | |
| Japan | 3481.1 | 6 | 74.3 | 10 | 22.8 | 10 | 26 | 8 |
| Korea | 513.3 | 15 | 2.3 | 13 | 53.9 | 7 | | |
| Lao | 240.9 | 24 | | | | | | |
| Malaysia | 3.2 | 75 | | | 44.5 | 12 | 162.6 | 1 |
| Myanmar | 1.4 | 80 | | | | | | |
| Philippines | 0.7 | 90 | | | 0 | 26 | | |
| Singapore | 9146 | 2 | | | 35.9 | 13 | 20.6 | 10 |
| Taiwan | 33.2 | 37 | | | 2.4 | 19 | | |
| Thailand | 55.5 | 34 | | | 0.1 | 25 | | |
| Vietnam | 0.1 | 100 | | | | | | |
| **Total** | **102058.7** | | **3719.9** | | **792.4** | | **888.9** | |

Source: India: Ministry of Finance, Pakistan: Board of Investment, 2010, Sri Lanka: Board of Investment, 2010, Bangladesh: Board of Investment

## III. Potential and Impacts of Enhancing Economic Linkages

A number of studies have suggested that the potential for enhancing linkages between South Asia and East Asia is large and the impacts of enhancing such linkages are also large. First, calculation of revealed comparative advantage and complementarity indices show that there is substantial potential for enhancing trade between the two regions (e.g., World Bank 2010 and Rana and Dowling 2009). Although there are significant overlaps, South Asia has a comparative advantage mainly in primary goods and labor-intensive manufactures and IT services, while East Asia has comparative advantage across a much wider range of products. These include primary goods such as crude rubber and fish, labor-intensive manufactures such as textiles, travel goods and footwear and more capital-and knowledge-intensive items such as office machines and telecommunications equipments.

Second, beyond the static analysis above, there is substantial potential for South Asia to link itself to production networks in East Asia and the world: India could also develop production networks in South Asia in agro-processing and services. Multinational-led production networks (product fragmentation and vertical specialization) were key contributors to regional integration and dynamism of East Asia. Recent evidence of rising FDI from East Asia to South Asia (discussed above) and increasing real wages in the coastal provinces of China, suggest the potential of linking South Asia with East Asia. South Asian countries have some production sharing with East Asia in apparel and textiles (e.g., Bangladesh, Sri Lanka, and India), in automobiles (e.g., India), electrical and telecom parts (e.g., Sri Lanka), but a lot more needs to be done.

Production networks of the 1960s and 1970s in East Asia were based on Akamatsu's "flying geese theory" of the nexus between FDI and trade and were triangular in nature: Japan and the NIEs exported parts for electrical appliances, office and telecommunication equipment and textiles to third generation countries (Indonesia, Malaysia, the Philippines, and Thailand) which in turn completed the processing process and exported the finished product to the US and Europe. Since the mid-1990s, more sophisticated and complex production networks have emerged which involve the transshipment of components – back and forth trade in components across boundaries. Jones and Kierzkowski (1990) and Kimura and Ando (2005) have developed the "augmented fragmentation and new geography" theory to explain these developments.

The newer theory of trade notes that the drivers of trade go beyond factor endowments and complementarities to the use of ICT, technology, and new geography. This theory assumes (i) countries with different factor endowments (ii) effective policies to mobilize FDI and a dynamic private sector (iii) technology that allows product fragmentation, and (iv) not-too-expensive service link cost to connect fragmented production processes.

Third, by using an augmented gravity model, De (2010) has found that East Asia shows the greatest potential for growth for South Asia. India's trade potential is the highest with the Asia-Pacific region, followed by the European Union and NAFTA, and then by South Asia. The estimates of the gravity model suggest that trade with developing East Asia has the potential to increase by 32 per cent per annum by 2014 (or an incremental $360 billion in exports by 2014 compared to an actual of $126 billion in 2008). This is twice the potential increase in trade with the EU and thrice as large as with NAFTA.

Fourth, using GCE modeling, Francois and Wignaraja (2008) have found that a broader South Asia-East Asia integration would provide larger income gains to South Asia than South Asia integration alone (Table 6). South Asian countries as a group would gain $22.4 billion or 2 percent relative to 2017 baseline income (in constant 2001 prices). This estimated gain is much higher than income gains to South Asia from a South Asian free trade agreement under the SAFTA ($3.7 billion or 0.3 percent of the baseline income). Interestingly, their results also show that if only India were to participate in an FTA with East Asia, other South Asian countries would lose. If, however, India were to bring in other South Asian countries as well, all countries in South Asia as well as East Asia would benefit from a broader South Asia-East Asia FTA.

**Table 6:** Income effects of alternative FTA scenarios

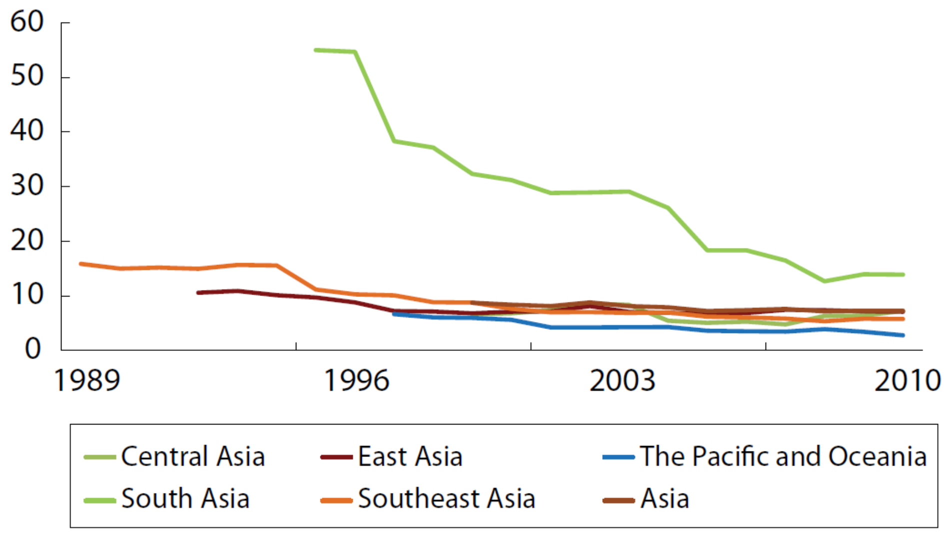
| | **South Asia FTA** | | **East Asia FTA** | | **East Asia and India FTA** | | **South Asia and East Asia FTA** | |
|---|---|---|---|---|---|---|---|---|
| | **Value $ Mn** | **% change** | **Value $ Mn** | **% change** | **Value $ Mn** | **% change** | **Value $ Mn** | **% change** |
| **South Asia** | **3,695** | **0.33** | **(3,620)** | **(0.32)** | **16,199** | **1.44** | **22,423** | **1.99** |
| Bangladesh | 351 | 0.31 | (297) | (0.26) | (355) | (0.31) | 1,874 | 1.66 |
| India | 1,138 | 0.14 | (2,371) | (0.30) | 17,779 | 2.23 | 18,240 | 2.29 |
| Pakistan | 625 | 0.42 | (824) | (0.55) | (862) | (0.58) | 298 | 0.20 |
| Sri Lanka | 335 | 1.08 | (117) | (0.38) | (123) | (0.40) | 631 | 2.03 |
| Others | 1,246 | 3.37 | (12) | (0.03) | (240) | (0.65) | 1,380 | 3.73 |
| **East Asia** | **(540)** | **(0.01)** | **226,855** | **2.17** | **239,097** | **2.29** | **241,485** | **2.31** |
| ROW | 361 | 0.00 | (9,316) | (0.03) | (3,934) | (0.01) | (3,001) | (0.01) |
| **World** | **3,516** | **0.01** | **213,919** | **0.45** | **251,363** | **0.52** | **260,907** | **0.54** |

Source: Francois and Wignaraja (2009). ROW is the rest of the world. Changes are computed relative to 2017 baseline at constant 2001 prices.

### IV. Policy Recommendations

The potential dynamic gains by linking production networks and developing new ones exceed the static gains through revealed comparative advantage discussed in the previous section. What are the policies and actions that need to be implemented to (i) link South Asia with production networks in East Asia and (ii) for India to develop production networks in services and manufacturing in South Asia? South Asia countries need to implement under the LEP2. These policies comprise (i) completing the remaining policy reform agenda especially in the microeconomic areas (ii) lobbying and negotiating to participate on various on-going regional trade and financial cooperation efforts in East Asia and (iii) improving trade facilitation and connectivity with East Asia to reduce trading costs between the two regions.

The first component of LEP2, should be to complete the reform process begun in the early 1990s by focusing on microeconomic reforms. South Asia has made significant progress in reducing tariff barriers to external trade. But there is still room to reduce these barriers further as they are higher in South Asia than in other Asian regions (Figure 4).




Source: Asian Economic Integration Monitor, July 2012

MFN = Most favored nation

**Figure 4:** MFN tariff trends in Asia (weighted using imports)

Also to enhance their competitiveness, attract FDI, and generate supply-side responses South Asian countries need to accelerate the implementation of the second generation reforms at the microeconomic level (regulatory environment, labor market flexibility, and infrastructure) level (Rana, 2012b). These comprise continued reforms of the agricultural and industrial sector; public institutions for improved governance at all levels (civil service, bureaucracy, and public administration); institutions that create or maintain human capital (education and health); and improving the environment affecting the private sector (regulatory environment, flexibility in labor market, legal and physical infrastructure, and clearly-defined property rights). These reforms are required to mobilize domestic private sector investment as well as to reduce "behind the border costs" for trade and FDI. In India, for example, manufacturing comprises only 15 per cent of the GDP. India has made little progress in manufacturing since the 1960s because it is constrained by entrenched bureaucracy, poor infrastructure, and restrictive labor laws. Unlike in China, therefore, this sector has not been able to absorb too much labor force. This is now starting to change and the Indian model of service-led growth is slowly starting to give way to the more traditional development model where both industry and services drive economic growth and create jobs. But the journey is long.

Unlike macroeconomic reforms, however, successful implementation of second-generation reforms requires a wider consensus in the countries and a long-term orientation. As an ADB (2009) report notes: "The dilemma is that such reforms generate benefits only in the long term, making them hard for policymakers with short time horizons to set as priorities. Yet without them, policy measures to support sustained economic growth will become less and less effective" (page 4).

The need for second generation reforms in South Asia is highlighted by various indicators from the World Bank and the ADB. According to the World Bank's Doing Business Survey 2011, in terms of overall "doing business" rankings, South Asia, on average, ranks lower than East Asia and Latin America and like most other regions, South Asia's average ranking deteriorated in 2011 compared to 2005 (Table 7). The only subregion that ranks lower than South Asia is Africa. Poor performance of South Asia reflects mainly difficulties in trading across borders. India's ranking in 2011 was 132 similar to that of Cambodia, Indonesia, and the Philippines mainly due to difficulties in starting a business.

The second component of LEP2 should be lobbying and negotiating to participate in various on-going regional trading agreements and financial cooperation efforts in East Asia. As in other parts of the world and as mentioned above, there has been a proliferation of FTAs between South Asia and East Asia. Currently, there are 9 FTAs in effect and another 13 are under negotiation or proposed. India, followed by Pakistan, has been the most active in negotiating FTAs with East Asia. In 2010, the ASEAN-India FTA became effective, but this FTA permits free trade in goods only and India is allowed to protect its service industry for some time. Given the large potential, the recent (at the ASEAN-India Summit in December) finalization of the investment and services chapter of the ASEAN-India FTA is a welcome development. Wider and deeper FTAs bring significantly more benefits than narrower and trade-lite FTAs (Francois and Wignaraja 2008). South Asia should therefore form comprehensive FTAs with East Asia with simple rules of origin. As a dialogue partner, India is already involved in negotiating the RCEP. Eventually with India's help, other South Asian countries could also lobby to join the RCEP.

India could also participate in financial cooperation efforts in East Asia. Two years ago, the former Thai Minister of Finance Chalongphob Sussangkarn (2010) had proposed that India, Australia, and New Zealand be made associate members and contributing partners – short of full membership -- of the Chiang Mai Initiative Multilateralization, a $240 billion bailout fund among ASEAN+3 countries. This should be explored further. “Expanded” membership of the CMIM and the Economic Review and Policy Dialogue would strengthen Asia’s voice at the G20 high-table (Rana 2012c). Joint policy coordination meetings of the expanded ASEAN+3 would provide a robust regional agenda for the ASEAN chair to table at the G20 Summits.

The third component of LEP2 should be creating a trade-friendly environment “behind the border” and improving trade facilitation[8] “at the border”. To improve trade facilitation at the border, delays in customs inspection, cargo handling and transfer, and processing of documents need to be modernized. Customs procedures need to be modernized by (i) aligning the customs code to international standards, (ii) simplifying and harmonizing procedures, (iii) making tariff structures consistent with the international harmonized tariff classification, and (iv) adopting and implementing the WTO Customs Valuation Agreement. South Asian countries have made considerable progress in implementing many of these procedures but a lot more remains to be done.

“Behind the border” regulatory environment and quality of infrastructure also needs to be improved. Data from the ADB suggest that the real costs to export and import are, on average, higher in South Asia than in East Asia and Latin America (Table 8). Again it is only Africa that performs worse than South Asia and the only Asian sub-region which fares worse than South Asia is Central Asia. The number of documents required for exporting and importing in South Asia are twice those in high-income countries.

[8] Initially, trade facilitation was considered to include efforts directed only at easing documentation burden and improving logistics of transporting goods across borders. This definition has now expanded to encompass the overall environment for international transactions, such as transparency and professionalism of customs, harmonization of standards, and conformance to international or regional regulations. In broad terms, trade facilitation is now thought to comprise all factors that contribute to a country’s capacity and effectiveness to create and maintain a trade-friendly environment. These factors are normally further split into two broad categories: “border” barriers to trade such as port efficiency and customs administration as well as “behind the border” barriers such as quality of infrastructure and regulatory environment. But “beyond the border” connectivity is also an important determinant of trading costs and competitiveness. Hence this paper uses a broad definition of trade facilitation. Trade costs can be large: Tax equivalent of representative trade costs for rich countries is 170 per cent (Anderson and van Winkoop 2004)

Table 9 compares the quality of infrastructure across the various Asian sub-regions. It shows that although the quality of infrastructure in 2012 has improved across all Asian sub-regions compared to that in 2008, the overall quality of infrastructure is the worst in South Asia followed by Central Asia. The quality of infrastructure in South Asia is on average about 60 per cent of the G7 level, while the corresponding figure was 90 per cent in East Asia. Overall, the quality of infrastructure in Asia is on average three-quarters that of the G7.

Table 7: Doing Business Indicators

| | Ease of doing business 2013 | Ease of doing business 2005 | Starting a Business | Dealing with construction permits | Getting electricity | Registering property | Getting credit | Protecting investors | Paying taxes | Trading across borders | Enforcing contracts | Resolving insolvency |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **South Asia Average** | 125 | NA | 89 | 124 | 129 | 117 | 86 | 82 | 123 | 130 | 142 | 112 |
| Bangladesh | 129 | 65 | 95 | 83 | 185 | 175 | 83 | 25 | 97 | 119 | 182 | 119 |
| India | 132 | 116 | 173 | 182 | 105 | 94 | 23 | 49 | 152 | 127 | 184 | 116 |
| Nepal | 108 | 55 | 105 | 97 | 96 | 21 | 70 | 82 | 114 | 171 | 137 | 121 |
| Pakistan | 107 | 60 | 98 | 105 | 171 | 126 | 70 | 32 | 162 | 85 | 155 | 78 |
| Sri Lanka | 81 | 75 | 33 | 112 | 103 | 143 | 70 | 49 | 169 | 56 | 133 | 51 |
| Average | | | | | | | | | | | | |
| **East Asia Average** | 79 | NA | 91 | 67 | 69 | 83 | 84 | 77 | 72 | 69 | 80 | 98 |
| Brunei | 79 | NA | 135 | 43 | 29 | 115 | 129 | 117 | 22 | 40 | 158 | 46 |
| Cambodia | 133 | 13 | 175 | 149 | 132 | 115 | 53 | 82 | 66 | 118 | 142 | 152 |
| China | 91 | 91 | 151 | 181 | 114 | 44 | 70 | 100 | 122 | 68 | 19 | 82 |
| Hong Kong | 2 | 7 | 6 | 1 | 4 | 90 | 4 | 4 | 4 | 2 | 10 | 17 |
| Indonesia | 128 | 115 | 166 | 75 | 147 | 98 | 129 | 49 | 131 | 37 | 144 | 148 |
| Japan | 24 | 10 | 114 | 72 | 27 | 64 | 23 | 19 | 127 | 19 | 35 | 1 |
| Korea | 8 | 27 | 24 | 26 | 3 | 75 | 12 | 49 | 30 | 3 | 2 | 14 |
| Lao | 163 | 147 | 81 | 87 | 138 | 74 | 167 | 184 | 126 | 160 | 114 | 185 |
| Malaysia | 12 | 21 | 54 | 96 | 28 | 33 | 1 | 4 | 15 | 11 | 33 | 49 |
| Philippines | 138 | 113 | 161 | 100 | 57 | 122 | 129 | 128 | 143 | 53 | 111 | 165 |
| Singapore | 1 | 2 | 4 | 2 | 5 | 36 | 12 | 2 | 5 | 1 | 12 | 2 |
| Thailand | 18 | 20 | 85 | 16 | 10 | 26 | 70 | 13 | 96 | 20 | 23 | 58 |
| Vietnam | 99 | 99 | 108 | 28 | 155 | 48 | 40 | 169 | 138 | 74 | 44 | 149 |
| **Latin American Average** | 97 | 96 | 80 | 74 | 116 | 89 | 90 | 113 | 89 | 96 | 80 | 74 |
| **Africa Average** | 141 | NA | 123 | 113 | 159 | 124 | 109 | 119 | 126 | 138 | 125 | 128 |
| **OECD Average** | 34 | NA | 64 | 63 | 63 | 60 | 49 | 62 | 61 | 41 | 42 | 35 |

Source : World Bank 2013

**Table 8:** Trade facilitation costs per subregion 2012

| | Real cost to export | Real cost to import | Time to export | Time to import | Documents to export | Documents to import |
|---|---|---|---|---|---|---|
| | Man days[1] | Man days[1] | Days | Days | Number | Number |
| High-income countries[2] | 6 | 6.4 | 8.9 | 8.6 | 4 | 4.7 |
| Latin America | 25.1 | 28.5 | 20.7 | 15.2 | 6.2 | 6.3 |
| Africa | 114.7 | 152.3 | 38.3 | 29.5 | 9.1 | 8.2 |
| **Asia** | **9.9** | **12** | **16.4** | **14.8** | **5.7** | **6.4** |
| East Asia | 7.2 | 7.6 | 16 | 14.1 | 5.7 | 4.7 |
| Southeast Asia | 9.4 | 11.7 | 13.2 | 13.2 | 4.9 | 5.9 |
| Central Asia | 41.4 | 64.8 | 56.5 | 59.9 | 8.6 | 10.2 |
| South Asia | 34.5 | 35.6 | 20.4 | 17.2 | 7.8 | 8.7 |

Source: ADB 2012.

Notes: Asia does not include the Pacific and Oceania. [1]Nominal costs to export/import per country were deflated by gross domestic product per work (in constant 1990 purchasing power parity $) per country and weighted based on each country's contribution to total regional/subregional export and import 2011 values. [2]Organisation for Economic Co-Operation and Development (OECD) high-income countries excluding Japan and Korea.

The fourth component is improving "beyond the border" physical infrastructure, connectivity and logistics. Most cargo between South Asia and East Asia (about 80 per cent) moves by water and air as there are no land transport services that are operational at the present time (Rana and Dowling 2009). Rapid growth in trade has been accommodated through the introduction of larger container ships. Expansion and diversification of feeder services and bottlenecks, primarily in public ports, remain to be addressed. Land transit through Myanmar, a potential node between South Asia and East Asia, was not possible until recently. The recent cautious political and economic reforms in Myanmar have, however, provided a fillip to various connectivity projects (Figure 5). The topography in that part of Asia and ethnic conflicts in various states of Myanmar are still a constraint to connectivity. Suitable cost sharing approaches for cross-border projects and modalities for public-private partnership must also be found.

South Asia could link-up with the Master Plan on ASEAN Connectivity which seeks to promote enhanced physical, institutional, and people-to-people connectivity. The key projects that are either under implementation or under discussion are (i) the Mekong-India Economic Corridor (ii) Trilateral Highway connecting India with Myanmar and Thailand along the

Asian Highway 1[9] and (iii) the Kaladan Multimodal Transit Transport Project[10]. While the first project focuses on connecting automotive industry in Bangkok with those in Chennai, India, the other two focus on the development of the North East Region of India.

Under the second phase of ASEAN-India Connectivity, connectivity through the narrow stretch of land between Nepal and Bangladesh or the so-called “chicken neck” should also be addressed. Nepal could be a “land bridge” between the giant dynamic economies of India and China and China-Nepal-India and China-Nepal-India-Bangladesh Economic Corridors should be established.[11] [12] Lohani (2011) and Pandey (2006) see large opportunities for trade and investment between growth centers in India and China via a land route in Nepal. This is because as part of its development strategy, India is focusing on its north and northeastern states which are relatively backward. Similarly, China is focusing on its western and southern provinces as wages rise in the coastal regions. Also, trade between western China and India means over 5000 km of road/railway transport plus sea transport. Distances would be shorter through Nepal. The Nathula pass in Sikkim is another possibility for India-China trade but, although shorter, this route is not usable during the winter season. Nepal has mountain passes that are less than 4000 ft above sea level and are open in all seasons.

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9 In 2009, the Ministers of the East Asia Summit grouping (which includes India) had requested the Economic Research Institute for ASEAN and East Asia (ERIA) to conduct a study to connect the region and the ERIA came up with the concept of (i) the Mekong-India Economic Corridor (MIEC) and (ii) Trilateral Highway to enhance ASEAN-India Connectivity. The MIEC seek to integrate the four Greater Mekong Countries viz. Myanmar, Thailand, Cambodia and Vietnam with India through its east coast by sea. The concept is to connect Ho Chi Minh City (Vietnam) with Dawei (Myanmar) via Bangkok (Thailand) and Phnom Penh (Cambodia) and further linking to Chennai in India. The economic and industrial corridor is to constitute state-of-the art transportation infrastructure such as expressways and high-speed railway that connect major industrial agglomerations, modern airports, Special Processing Zones, and enabling policy frameworks. The Trilateral Highway project is expected to be completed by 2016. Both India and Myanmar are actively involved, and certain sections have already been completed

10 In April 2008, the Indian Government signed an agreement with the Myanmar military junta for the Kaladan Multi-Modal Transit Transport Project. The project seeks to connect the eastern Indian seaport of Kolkata with Sittwe port in Arakan State of Myanmar by sea; it will then link Sittwe to the land locked region of Mizoram in northeastern India via river and road transport. The project has three phases, the first and second of which began in November 2010.

11 The “land bridge” concept extends beyond transit state which involves building a road or a railway line for flow of vehicles: “Land bridge” also involves the establishment of production bases, industrial agglomerations and SEZs. Laos provides an interesting case of how landlocked countries can benefit by being a “land bridge”. AH15 and AH16 of the Asian Highway connect Vietnam and Thailand via Laos. The project called the East-West Corridor is 1,450 kilometers long. Work on the Laos-China railway is also to start in 2013.

12 Further West, landlocked Afghanistan could be a “land bridge” between Pakistan and Central Asia. A number of oil pipelines are being considered.

China has plans to extend the recently-opened Qinghai-Tibet railway to Nepal and India, and a second road link between Kathmandu in Nepal and Tibet is nearing completion. According to the *Economist* , roughly one-half of the Beijing-Lhasa Expressway (G6) until Xining has been completed, and the upgrading of the rest which is a national road (G109) is going well (*Economist* 2012). Section AH42 of the Asian Highway is to connect Barhi in India with Kathmandu and Lhasa in Tibet. Various road and rail corridors have also been proposed by the SAARC. Road corridors are: corridor-2 connecting Kathmandu to Kolkota via Birgunj, corridor-4 connecting Kathmandu to Mongla and Chittagong via Fulbari-Banglabandha, corridor-7 connecting Kathmandu to Karachi via Nepalgunj-New Delhi-Lahore, and corridor-10 connecting Kathmandu-Bhairawa-Lucknow. The rail corridors are: one connecting Birgunj with Kolkota/Haldia and the other connecting Birgunj with Mongla-Chittagong. The proposal to establish an Asian Infrastructure Fund with financing from various multilateral agencies and private-public partnership is making progress. The ADB has identified 21 high ticket infrastructure projects to connect Asia (ADB/ADBI 2009).

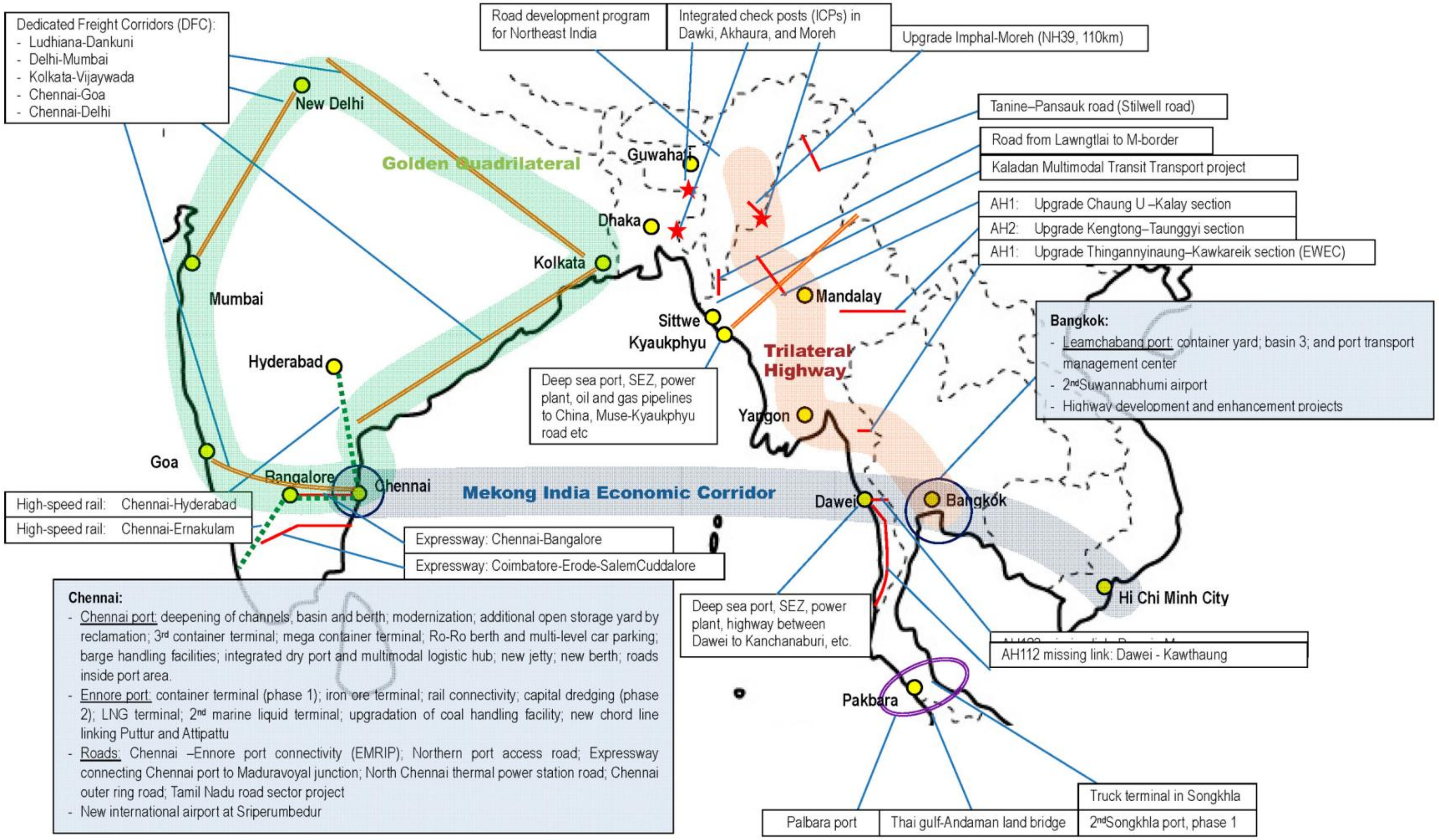
Summing up, the overall weaknesses in trade facilitation and connectivity are captured by the logistic performance index calculated by the World Bank using perception-based indicators. These use surveys of operators and the index ranges from 1 to 5 (lowest to highest) (Table 10). The index focuses on several variables: customs performance, infrastructure, international shipments, logistics competence, tracking and tracing, and timeliness. These indices also show that on average South Asia is not only behind the OECD but also East Asia, and Latin America. On average, South Asia is ahead of only Africa. South Asia ranks particularly low on the infrastructure component of the index. South Asia has, therefore, a long way to go in terms of improving trade facilitation and connectivity.

**Table 9:** Infrastructure Quality Index-Share of G7 Average by Subregion in 2012(%)

| | **Overall Infrastructure** | | **Infrastructure Type** | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | **Road** | | **Rail** | | **Port** | | **Air** | | **Electricit y** | |
| **Asia** | **76** | **(+9)** | **71** | **(+6)** | **69** | **(+2)** | **75** | **(+3)** | **80** | **(+1)** | **67** | **(+3)** |
| East Asia | 90 | (+9) | 87 | (+5) | 98 | (+9) | 92 | (+3) | 89 | (+1) | 90 | (+7) |
| Southeast Asia | 80 | (+6) | 79 | (+5) | 58 | (-1) | 83 | (+3) | 86 | (-2) | 73 | (0) |
| Central Asia | 71 | (+10) | 59 | (+5) | 64 | (-3) | 55 | (-4) | 71 | (-1) | 63 | (+7) |
| South Asia | 61 | (+10) | 60 | (+6) | 55 | (+3) | 70 | (+7) | 72 | (0) | 41 | (-3) |

Source: ADB 2012.

Notes: Asia does not include the Pacific and Oceania. [1]G7 includes Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. [2]Values are regional/subregional averages. Figures show the ratio between the indexed of the individual countries/regions and the G7 average. Figures in parentheses show the increase/decrease in index points from 2008.




Source: Economic Research Institute for ASEAN and East Asia

**Figure 5:** Selected infrastructure projects for ASEAN-India connectivity

**Table 10:** Logistic Perception Index, 2011

| Country | LPI Score | Customs | Infra-structure | International shipments | Logistics competence | Tracking/ tracing | Timeliness |
|---|---|---|---|---|---|---|---|
| **South Asia** | 2.68 | 2.60 | 2.48 | 2.68 | 2.71 | 2.58 | 2.96 |
| India | 3.08 | 2.77 | 2.87 | 2.98 | 3.14 | 3.09 | 3.58 |
| Nepal | 2.04 | 2.20 | 1.87 | 1.86 | 2.12 | 1.95 | 2.21 |
| Pakistan | 2.83 | 2.85 | 2.69 | 2.86 | 2.77 | 2.61 | 3.14 |
| Sri Lanka | 2.75 | 2.58 | 2.50 | 3.00 | 2.80 | 2.65 | 2.90 |
| **East Asia** | 3.20 | 2.95 | 3.07 | 3.16 | 3.14 | 3.27 | 3.57 |
| Cambodia | 2.56 | 2.30 | 2.20 | 2.61 | 2.50 | 2.77 | 2.95 |
| China | 3.52 | 3.25 | 3.61 | 3.46 | 3.47 | 3.52 | 3.80 |
| Indonesia | 2.94 | 2.53 | 2.54 | 2.97 | 2.85 | 3.12 | 3.61 |
| Japan | 3.93 | 3.72 | 4.11 | 3.61 | 3.97 | 4.03 | 4.21 |
| Korea | 3.70 | 3.42 | 3.74 | 3.67 | 3.65 | 3.68 | 4.02 |
| Laos | 2.50 | 2.38 | 2.40 | 2.40 | 2.49 | 2.49 | 2.82 |
| Malaysia | 3.49 | 3.28 | 3.43 | 3.40 | 3.45 | 3.54 | 3.86 |
| Myanmar | 2.37 | 2.24 | 2.10 | 2.47 | 2.42 | 2.34 | 2.59 |
| Philippines | 3.02 | 2.62 | 2.80 | 2.97 | 3.14 | 3.30 | 3.30 |
| Singapore | 4.13 | 4.10 | 4.15 | 3.99 | 4.07 | 4.07 | 4.39 |
| Thailand | 3.18 | 2.96 | 3.08 | 3.21 | 2.98 | 3.18 | 3.63 |
| Vietnam | 3.00 | 2.65 | 2.68 | 3.14 | 2.68 | 3.16 | 3.64 |
| **Latin America** | 2.80 | 2.52 | 2.68 | 2.79 | 2.73 | 2.85 | 3.20 |
| **Africa** | 2.48 | 2.30 | 2.33 | 2.48 | 2.44 | 2.43 | 2.86 |
| **OECD** | 3.62 | 3.42 | 3.66 | 3.43 | 3.62 | 3.68 | 3.91 |

Source: World Bank (2011).

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