Re-Energizing Economic Integration between South Asia and East Asia

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This chapter focuses on economic integration (linkages) between South Asia and East Asia.[2] The topic is important for three reasons. First, South Asia-East Asia (SA-EA) trade is a component of South-South trade and could be a useful buffer should North-South trade soften, or populism lead the North to view trade as a "zero-sum" game, as is presently the case in the United States and several countries in Europe. The withdrawal of the United States from the Trans-Pacific Partnership (TPP) in January 2017 and President Trump's reiteration of his "America First" trade policy at the 2017 APEC meetings in favor of bilateralism and "fair trade" has generated interest in alternate trade policy options in the EA region.

In addition to promoting domestic demand, EA countries have adopted a three-pronged response to rising U.S. protectionism:[3]

1. EA countries have been attempting to construct a new regional trade order and enhance connectivity. On November 11, 2017 the eleven remaining countries decided to go ahead with the TPP, while the Regional Comprehensive Economic Partnership (RCEP) negotiations are also to be expedited.[4] The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP or TPP11) which is led by Japan and Australia was signed on March 8, 2018 and is expected to be in force by early 2019 when at least six countries will have ratified it; this date may, however, slip a bit.[5] Singapore, which is the ASEAN Chair for 2018 has announced that it would try its best to have the RCEP signed this year. But India is still not ready and is concerned with its rising trade imbalance with China and wants other countries to liberalize their service sectors in return. Earlier this year, the leaders came up with the Delhi Declaration (discussed below) and to fast-track RCEP an "RCEP minus X" formula is gaining traction.
2. EA countries have also stepped up joint efforts to enhance regional connectivity through infrastructure development. The headline-grabbing activity is China's Belt and Road Initiative (BRI), which seeks to connect more than seventy countries across the Afro-Eurasian supercontinent via large-scale projects like railways, roads, bridges, ports, and pipelines. ASEAN has unveiled its new "Master Plan on ASEAN Connectivity 2025," which includes several region-wide infrastructure projects.

   India is collaborating with Japan under the Asia-Africa Growth Corridor proposal launched in 2017 to develop maritime connectivity to link Africa, India, and other countries in Southeast Asia. India, together with the United States, Japan, and Australia, is also involved in the Indo-Pacific Partnership, also called the Quad 2.0, which was revived during Trump's visit to Asia in November 2017. Unlike the BRI where six land corridors and one maritime corridor have been identified, the Asia-Africa Growth Corridor proposal and the Indo-Japan Partnership are still at a consultation stage.
3. EA countries are seeking to enhance inter-regional cooperation including SA-EA integration. In early March, the Philippines ratified its European Free Trade Agreement. Japan and the European Union are expected to finalize an Economic Partnership Agreement this summer. Australia and New Zealand hope to conclude their FTAs with the European Union this year and ASEAN hopes to resume its stalled region-to-region FTA negotiation with the EU in the next few months. Recently Korea signed FTAs with a number of Central American countries, and

> Singapore is negotiating an FTA with the Pacific Alliance, which comprises Chile, Colombia, Mexico, and Peru. At the recent summit in New Delhi, ASEAN and India came up with the Delhi Declaration which seeks to "Further strengthen and deepen the ASEAN-India Strategic Partnership for mutual benefit across the whole spectrum of political-security, economic, socio-cultural and development cooperation."[6]

Second, the potential economic effects of SA-EA integration are favorable. Deeper SA-EA integration would be mutually beneficial to both regions and could jumpstart South Asia, currently an economic laggard. SA-EA integration could also revive economic integration in SA, a region which was once well-integrated but now is among the least integrated regions of the world.[7]

Third, if as some say, we are witnessing the "Renaissance of Asia" and the rise of the Asian century, we need a robust level of SA-EA trade and investment to support the process. In the post-1990 period, traditional trade (trade in final goods) between SA and EA has increased rapidly, albeit from a low base. Partial economic reforms implemented by South Asian countries and their Look East Policies (LEP), adopted either formally or informally, have played a role. However, South Asia's participation in global production networks and supply chains is still limited. In 2014, the Modi government adopted an Act East Policy signaling a more pro-active approach towards East Asia than in the LEP of the past.[8] It broadens the coverage of the LEP from Southeast Asian countries to all East Asian countries and seeks to build economic, institutional, and defense links to the region. It also seeks to involve East Asian countries in India's ongoing economic transformation and seeks their participation in joint projects.[9] The Act East Policy of India has, however, yet to spell out any focused policies that link the country to global production networks.

While the literature on economic integration in regions of Asia such as East Asia, ASEAN, and South Asia is extensive, the literature on recent trends in integration (or linkages) between SA-EA is limited. It started mainly with the research conducted at the ADB in the early 2000s.[10] This chapter contributes to the relatively sparse literature on the subject with two objectives: 1) to argue that South Asian countries need to embark on a second round of LEP2 to link themselves to global production networks, especially those in East Asia, their largest potential market;[11] and 2) to identify policies that South Asian countries should implement as part of LEP2. LEP2, together with LEP, will allow SA (and EA) countries to benefit not only from the static complementarities associated with traditional trade theories but also from the dynamic complementarities of the trade theory of product fragmentation.[12]

An important differentiating factor is that, unlike other studies on the subject, this chapter develops and estimates a logit model with random effects to identify the determinants of production network participation and derive policies to drive SA-EA integration. The first section focuses on historical trends and argues that an integrated and prosperous Asia existed during much of the first 18 centuries of the Christian era. The following section presents more modern trends, focusing on trade linkages between the two regions. Next, an econometric model which explains production network participation rates of Asian countries is presented. Based mainly on the model, we then identify policies that South Asian countries should implement under their LEP2 before concluding.

Historical Trends

Authors have argued that SA has a long history of economic ties along with cultural and religious exchange with EA dating back to the pre-Christian era.[13] The first millennium of the Christian era was a period of trade and economic growth between India and China. Exports from India were comprised mainly of rice, sugar, and cotton textiles, while imports were more varied and included Indonesian spices, various kinds of wood, Chinese silk, tea, gold, and non-precious metals such as tin, copper, and vermillion. China and India were in contact with each other through a network of land and sea routes that eventually evolved into the Silk Road.

The opening of the Straits of Malacca in the 5th century provided further impetus to India-China trade. The emergence of the Chola Empire in south India and the Sung Dynasty in China in the 10th and 11th centuries as large and prosperous regions provided another stimulus to regional trade and exchange. The 15th century voyages of Admiral Zheng He are also well-known. By the end of that century, Western explorers had also started to trickle in. Hence, during the pre-colonial period, trade between SA and EA was strong, and Asia was not only the dominant region of the world, but also the most integrated one as well.

This situation, however, changed in the mid-15th century when China, for some unknown reason, suddenly reversed its previous policy and closed its economy. Japan too followed an isolationist foreign policy during the Edo period (1603 to 1868) and trade between Japan and other countries was severely restricted. Also Asia was colonized in the 19th century—mainly by the British but also by the French, Dutch, and Portuguese. The colonizers divided up most of Asia into spheres of influence, took control of trade and customs and restricted access to inland waterways. They destroyed pre-existing Asian trading systems and diverted profits to Europe. This distorted center-periphery relations by making Europe stronger and Asian kingdoms weaker.[14] As a result of these factors economic linkages between SA-EA also weakened.

Modern (Postcolonial) Trends

Two distinct periods of SA-EA integration can be identified in the modern era: a period of limited integration from independence until the late 1980s, and one of intensifying efforts at integration from 1990 onwards. After independence from the British in 1947, India's first prime minister, Jawaharlal Nehru, started to re-engage with East Asia. The Asian Relations Conference held in New Delhi in 1947 under his leadership served as one of the earliest attempts to form a Pan-Asian identity. Forming a common cause with other Asian leaders on Western imperialism and developing world solidarity, Nehru helped forge the "Bandung Spirit" of 1955, which led to the non-aligned movement. However, this phase of India's engagement with East Asia ended with India's border war with China in 1962 and its preoccupation with Pakistan. India turned inward and adopted the closed Soviet model of economic development characterized by import-substitution policies and high levels of protection. The other smaller South Asian countries followed suit with significant adverse consequences.

The period after 1990 to the present has been marked by intensifying efforts at regional integration between SA and EA. South Asian countries took two major sets of actions. First, they have partially liberalized their trade and investment regimes through the implementation of gradual macroeconomic and structural reforms. Economic reforms began in Sri Lanka in the early 1980s supported by various facilities from the IMF. India initiated reforms in the 1980s and deepened them post-1991. Bangladesh started to liberalize its trade and industrial policies in the early 1990s. Nepal and Pakistan began their economic reform program in the late 1990s.[15]

Second, as part of its economic reform program, India adopted the LEP in 1991 to promote closer ties with Southeast Asian countries.[16] Bangladesh followed suit in late 2002,[17] and Pakistan in 2003 with its "Vision East Asia" initiative.[18] Other South Asian countries did not announce a formal LEP but have taken a number of policy actions to promote trade and investment and connectivity with East Asia. These have had numerous positive impacts.

India has been actively participating in various consultative meetings and dialogues initiated by ASEAN such as the ASEAN Regional Forum, East Asia Summit, and the Mekong-Ganga Cooperation. India holds summit-level dialogues with ASEAN. As a part of its Act East Policy and to celebrate the 25th anniversary of India-ASEAN dialogue, earlier this year India hosted the ASEAN-India Commemorative Summit in New Delhi. India, together with Bangladesh and Sri Lanka, is also a member of the Asia-Pacific Trade Agreement. India, Bangladesh, Sri Lanka, Nepal, and Bhutan are members of the Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation (BIMSTEC).

As part of its LEP, India has signed free trade agreements (FTAs), including the Comprehensive Economic Cooperation and the Comprehensive Economic Partnership Agreements, with ASEAN as a whole and two members, Singapore and Malaysia. An ASEAN-India FTA in goods was signed in 2014, and the ASEAN-India Services Trade and Investment Agreement was signed a year later. India has also signed FTAs with Japan and Korea. FTAs with Thailand and Indonesia and the RCEP are in process. Pakistan has signed FTAs with China, Malaysia, and Indonesia, and FTAs with Singapore and Thailand are in the pipeline. In contrast to India and Pakistan, other South Asian countries appear to be more cautious in signing FTAs. Maldives has signed an FTA with China, while Sri Lanka is in the negotiating stage. Sri Lanka recently signed an FTA with Singapore.

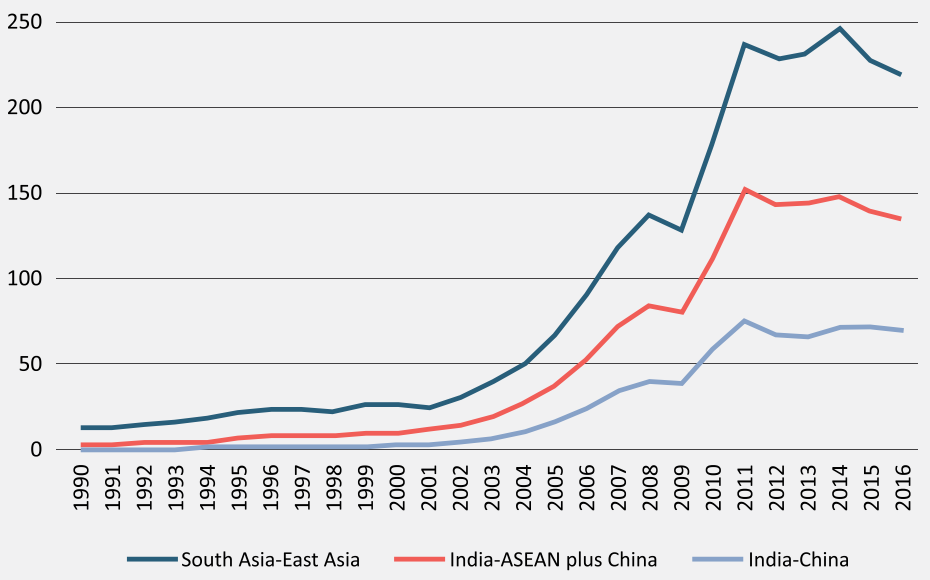
In the area of connectivity and infrastructure development, South Asian countries are more active. All eight South Asia Association for Regional Cooperation (SAARC) members, aside from Afghanistan and Bhutan, are founding members of the Asian Infrastructure Investment Bank (AIIB). But unlike other South Asian countries, India is not supportive of China's Belt and Road Initiative (BRI) mainly because the China-Pakistan Economic Corridor, which is one of the six land corridors under the BRI, passes through territory disputed between the two countries. The Bangladesh-China-India-Myanmar (BCIM) Economic Corridor, which is another corridor under the BRI, has not progressed much because of India's slow response. There has already been one significant military standoff between India and China in 2017 when China attempted to build a road that crossed in to territory that is claimed by Bhutan on the Doklam Plateau, with India stepping in on behalf of Bhutan, which is considered a "protected" state. As discussed earlier, India is instead involved in other arrangements which are seen as alternates to the BRI.

Traditional Trade Flows in Final Goods

Economic reforms and the LEPs implemented both formally and informally by the South Asian countries have helped deepen economic linkages between SA and EA. Table 1 and Figure 1 show that SA's total merchandise trade (exports plus imports) to EA grew rapidly by 19.5 per cent per annum between 1990 and 2016 (albeit from a low base). The value of total trade between SA and EA amounted to $219.4 billion in 2016 (up from $12.7 billion in 1990). The annual growth rate was relatively moderate until 2002, but it has surged since then. The exception was in 2009 when it dipped (due to the global economic crisis) and again during 2012 to 2016 when it fell slightly. The latter development can be explained by the economic slowdown in SA as the pace of reforms slowed in recent years[19] and the slower pace of economic growth in EA, especially with China rebalancing growth to more domestic demand and quality growth. As expected, the two largest components are the bilateral trade between the two "giant" economies of India and China, and the trade between India and ASEAN. Bilateral trade between these partners has softened a bit since 2012 with the latter slowing more than the former.

There are, however, two issues that should be noted: 1) India accounts for the largest share of SA-EA total trade, with Pakistan and Bangladesh a distant second and third (other countries trade much less with East Asia (Table 1)); and 2) all South Asian countries have a trade imbalance with East Asia, with India's imbalance being the largest (about $90 billion or about 4 per cent of its GDP) (Table 1).

Figure 1: Total trade between South Asia and East Asia ($ billion) (1990-2016)



Source: International Monetary Fund, Direction of Trade Statistics.

Global Production Network Trade

The IMF has estimated that trade in intermediate products comprises nearly two-thirds of total world trade.[20] East Asia is dense with production networks and supply-chains.[21] It is estimated that EA accounts for nearly 45 percent of the global production network (or supply-chain trade), with China and the ASEAN countries in the lead. Participation in production networks and supply chains has transformed the Asian trade landscape, contributed to deepening regional economic integration, and brought about unprecedented prosperity.[22]

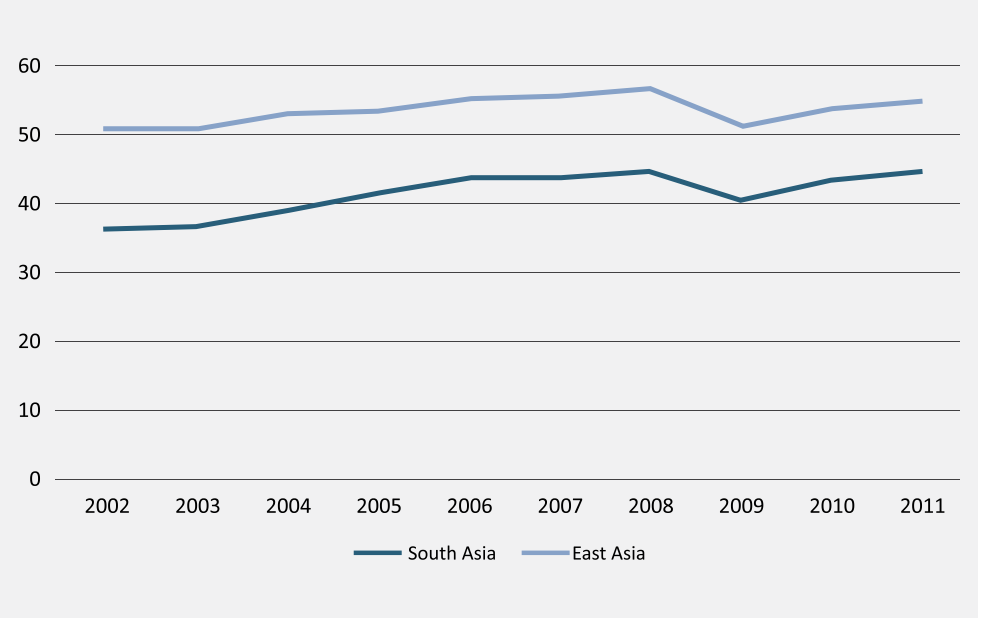
Table 1: Growth in South Asia's Trade with East Asia, 1990-2016

	Value in 2016 $million	Annual Average Growth (%) 1990-2016
TOTAL TRADE		
South Asia	219,441	19.5
India	163,911	22.5
Pakistan	24,127	13.9
Bangladesh	20,355	17.9
Sri Lanka	7,031	12.2
Nepal	1,295	9.2
Maldives	948	14.3
Afghanistan	1,772	11.9
EXPORTS		
South Asia	48,600	17.0
India	42,978	19.2
Pakistan	2,830	6.8
Bangladesh	1,985	17.3
Sri Lanka	721	8.8
Nepal	27	4.4
Maldives	52	7.8
Afghanistan	6	5.0
IMPORTS		
South Asia	170,841	20.4
India	120,933	24.2
Pakistan	21,297	12.7
Bangladesh	18,370	18.0
Sri Lanka	6,310	15.8
Nepal	1,268	9.4
Maldives	896	14.9
Afghanistan	1,766	12.0

Notes: No data for Bhutan.
Source: IMF Direction of Trade Statistics Database.

While EA countries are participating actively in the global production network (parts and components) trade, SA countries are lagging. Figure 2 shows production network participation (PNP) rates in EA and SA during the period 2002 to 2011 (the latest year for which data are available) using the global value chain (GVC) participation rates published by UNCTAD.[23] The data show that while the PNP rate increased in both SA and EA during the entire period except in 2009, it increased faster in the former region. Hence, the PNP gap between the two regions has narrowed somewhat although it continues to remain high.

Figure 2: Global Value Chain Participation Rates in South Asia and East Asia (percent) (2002-2011)



Source: UNCTAD-Eora GVC Database.

In order to benefit from this new type of parts and components trade, SA countries need to link themselves to global production networks—especially those in EA, their largest potential market.[24] Such policies, together with LEP, would allow South Asia to benefit from not only the static complementarities of traditional trade theories but also the dynamic complementarities associated with the new product fragmentation theories.[25] Focusing on trade in components and parts is a proven method for developing countries to move up the value-added chain, benefiting their long term development.

Determinants of Production Network Participation Rates

What policies should SA countries implement to link themselves to global production networks? In the recent modelling study by Rana and Chia,[26] we specify and estimate an econometric model of trade in parts and components, as in Golub et al.[27] We use UNCTAD's GVC participation rates as the dependent variable. As in Golub et al, logistics development in different forms, business environment, and regional economic ties are viewed as possible catalysts of GVC participation. These three are, therefore, the independent variables in our model.

Our model, takes the following form:

$$GVCP_{it} = \alpha_0 + \beta_1 GDPP_{it} + \beta_2 FDI_{it} + \beta_3 LPI_{it} + \beta_4 SAARC_i + \beta_5 ASEAN_i + \beta_6 IMPSTV_i + \beta_7 CHINA_i + \beta_8 INDIA_i + \beta_9 GFC_t + \mu_i + \nu_t + \varepsilon_{it}, \quad (1)$$

where ε_{it} is the stochastic error term. $GVCP_{it}$ is the GVC participation rate. As in Athukorala and Athukorala and Menon,[28] GDP per capita ($GDPP_{it}$), expressed in a logarithmic form, is included in the specification to control for a country's stage of economic development. FDI_{it} stands for the stock of FDI inflows per capita expressed in logarithmic form. It aims to capture how a business environment conducive to foreign investors influences GVC participation.[29]

Other variables are the logistics performance indicators (LPI) and the dummies for regional economic groupings. LPI_{it} is LPI expressed in a logarithmic form. $SAARC_i$ and $ASEAN_i$ are the dummies for SAARC and ASEAN groupings.[30] They take a value of unity if they are the members of the groupings, and zero otherwise. $IMPSTV_i$ is the dummy for ASEAN-6 countries (Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam). These countries are the major Southeast Asian players in global production networks. $CHINA_i$ and $INDIA_i$ are the dummies for China and India, respectively, and they are included to account for their size. is the time dummy for the global financial crisis in 2008-9 when international trade plunged sharply affecting GVC participation. μ_i and ν_t are unobservable country- and time-specific characteristics.

The model was estimated using data from 12 East Asian countries (data for Myanmar was not available) and 8 South Asian countries during the period 2002 to 2011 (the latest year for which data were available). Since the dependent variable ranges from zero to one, to enhance efficiency, the model is estimated by using the logit method.[31] Also, to address the biases due to omitted variables, random effects estimates were obtained using the generalized least squares (GLS) methods.

The estimated equation is presented in Table 2:

Table 2: Random Effects GLS Estimation of the GVC Participation Equations	
Variable	**GVC Participation**
$GDPP_{it}$	.2420*** (0.596)
FDI_{it}	.0247** (.0117)
LPI_{it}	.1894 (.1440)
$SAARC_i$	.4660* (.2763)
$ASEAN_i$	.7087** (.3331)
$IMPSTV_i$	.0950 (.2311)
$CHINA_i$	.0701 (.3606)
$INDIA_i$	-.1058 (.2900)
GFC_i	.0016 (.0270)
Constant	-3.062*** (.5474)
No. of Obs.	**185**
Wald Chi-Squared	**82.79*** **
Breusch-Pagan Test	**271.31*** **

Note: (1) *Statistically significant at 10%; **Statistically significant at 5%; ***Statistically significant at 1%;
(2) Robust standard errors in parentheses.
Source: Author's calculation.

The estimated equation shows the following results:

1. GVC participation is positively and significantly correlated with the level of a country's economic development. This is not surprising and is consistent with the casual observation that more advanced East Asian countries tend to participate more actively in global production networks than the lower-income South Asian countries (Figure 2).
2. Inward FDI is a key driver of GVC participation. This implies that countries with conducive business environments to foreign investors tend to participate more in GVC trade.[32]
3. Although the logistics performance variable has the correct sign suggesting that improved logistics facilitates GVC participation, it is not statistically significant even at 10 percent. When the sample was subdivided into the two components of GVC - "downstream" and "upstream"—the LPI_{it} variable was statistically significant only in the former case.[33]
4. The coefficient of $SAARC_i$ and $ASEAN_i$ the dummies are of the expected sign and are statistically significant suggesting that membership in a regional grouping facilitates GVC participation.

Second Round of "Look East" Policies

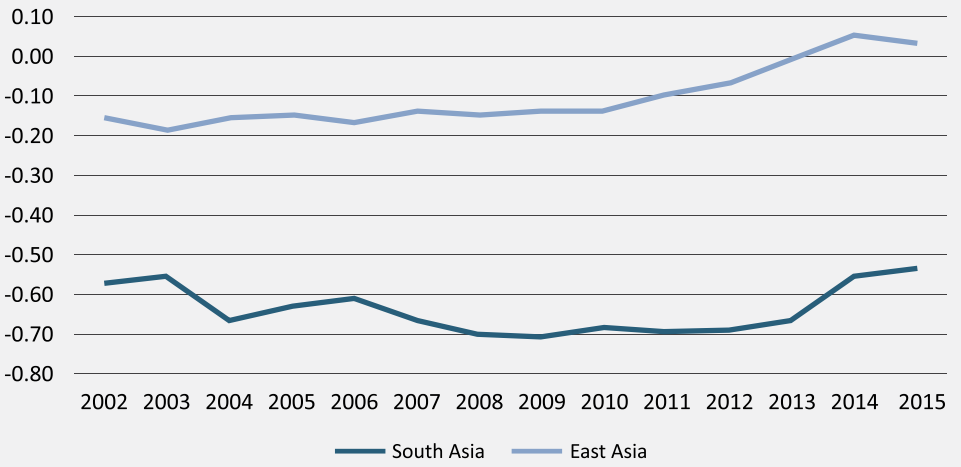
The econometric modeling of the previous section suggests that the LEP2 in SA countries should comprise the following policies: Improving the investment environment by deepening the reform process begun in the 1980s and early 1990s, reducing logistics costs including trade facilitation "at the border," and signing regional cooperation agreements with and participating in various on-going regional trade and financial cooperation efforts in EA. Although not included in the model, two related policies which are theoretically obvious are also considered. These are reducing communication and coordination costs in managing supply chains by improving ICT and enhancing regional physical connectivity through hardware and software development to reduce transport costs.

Therefore, LEP2 that should be implemented by SA countries should comprise five sets of, sometimes overlapping, policies. First, SA countries should deepen the economic reform process that they began in the 1980s and the early 1990s to attract investments (both domestic and foreign) and to reduce non-tariff barriers to trade. In particular, SA countries need to implement microeconomic reforms comprising sectoral reforms (agriculture and industrial sectors) and second-generation reforms. Second-generation reforms comprise reforms of public institutions for improved governance at all levels (civil service, bureaucracy, and public administration); of institutions that create or maintain human capital (basic and skill-setting education and health); and of the judicial system, regulatory environment, labor market, physical infrastructure, and property rights. These reforms are required to mobilize domestic private sector investment as well as to enhance supply-chain participation.[34]

The need for second-generation reforms in SA is highlighted by two indicators published by the World Bank. The first is the Worldwide Governance Indicators, which assess six broad dimensions of governance: voice and accountability, political stability and absence of violence/terrorism, government effectiveness, regulatory quality, rule of law, and control of corruption. In addition to these indicators, we also calculated an overall governance indicator (OGI) as the simple average of the six indicators in the World Bank database to assess trends.

Figure 3 shows that in 2002, OGI was higher on average in EA than in SA. From 2002 and 2015, the OGI increased in EA but fell in SA (until 2013). The governance gap has, therefore, widened. OGI indicators for individual SA countries are shown in Figure 4. From 2002 to 2012, OGI declined in Maldives and Pakistan, while it remained about the same in India. The OGI has, however, improved somewhat in Bangladesh and Nepal (after 2005), in Bhutan (after 2007), and in Sri Lanka (after 2008), when peace was restored. While Bhutan, Sri Lanka, and Maldives have the highest OGI in SA, Bangladesh, Nepal, Pakistan, and Afghanistan have the lowest. India falls somewhere in between.

Figure 3: OGI of South Asia and East Asia



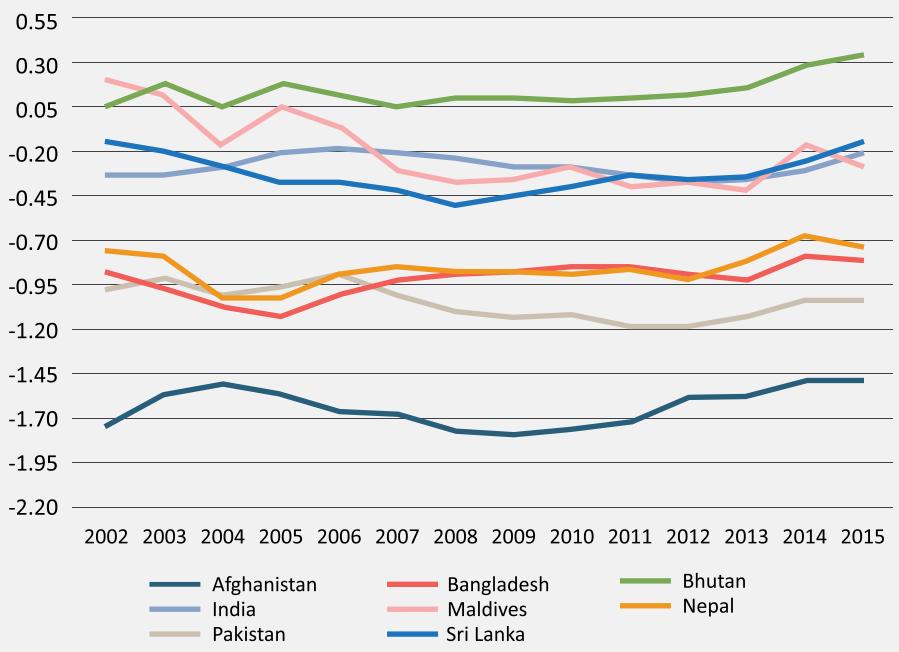
Note: The indicator ranges from -2.5 to +2.5 with higher value corresponding to better governance.
The sub-regional score is the simple average of the country scores.
Source: Author's calculations based on World Governance Indicators.

Also establishing the need for second-generation reform are the "ease of doing business indicators" published in *Doing Business Survey* 2018 by the World Bank. In overall "ease of doing business" rankings, SA, on average, ranks lower than EA and Latin America. As shown in Table 3, in most SA countries (with the exceptions of India and Nepal) the overall ranking deteriorated in 2018 compared to 2015. India moved up 30 places in the ranking (from 130 to 100), but in absolute terms its rank is still low (similar to that of the Philippines). The data show that the poor performance of SA countries reflects mainly difficulties in registering property, enforcing contracts, paying taxes, and trading across borders.

The second component of LEP2 should be to reduce logistic costs including "at the border" costs through trade facilitation. Logistic services involve planning, implementing, and controlling the efficient and cost-effective flow and storage of raw materials, inventory, and finished goods from point of origin to the point of consumption. With production fragmented across countries, efficient logistics is a key determinant of a country's competitiveness and ability to attract production blocks. Trade facilitation "at the border" is also important.

To improve trade facilitation "at the border," delays in customs inspection, cargo handling, and transfer and processing of documents need to be reduced. Customs procedures need to be modernized by: 1) aligning the customs code to international standards; 2) simplifying and harmonizing procedures; 3) making tariff structures consistent with the international harmonized tariff classification; and 4) adopting and implementing the WTO Customs Valuation Agreement. SA countries have made some progress in implementing many of these procedures, but much more remains to be done.

Figure 4: OGI for South Asian Countries



Note: The indicator ranges from -2.5 to +2.5 with higher values corresponding to better governance.
The sub-regional score is the simple average of the country scores.
Source: Author's calculation based on World Governance Indicators.

Table 3: Ease of Doing Business Indicators (2018)

	Ease of Doing Business Rank[1] 2018	Ease of Doing Business Rank[2] 2015	Starting a Business	Dealing with Construction Permits	Getting Electricity	Registering Property	Getting Credit	Protecting Minority Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving Insolvency
Afghanistan	183	183	107	185	163	186	105	189	176	175	181	161
Bangladesh	177	176	131	130	185	185	159	76	152	173	189	152
Bhutan	75	73	88	82	56	56	77	124	17	26	25	168
India	100	130	156	181	29	154	29	4	119	146	164	103
Maldives	136	135	68	54	143	174	133	132	118	152	106	139
Nepal	105	107	109	157	133	84	90	62	146	76	153	76
Pakistan	147	144	142	141	167	170	105	20	172	171	156	82
Sri Lanka	111	110	77	76	93	157	122	43	158	86	165	88
South Asia	129	134	110	126	121	146	103	81	132	126	142	121
East Asia	71	78	105	68	57	77	61	77	92	91	79	66
Latin America	110	107	116	111	86	118	92	114	126	101	107	107
OECD	27	25	47	46	40	44	62	47	40	25	47	24

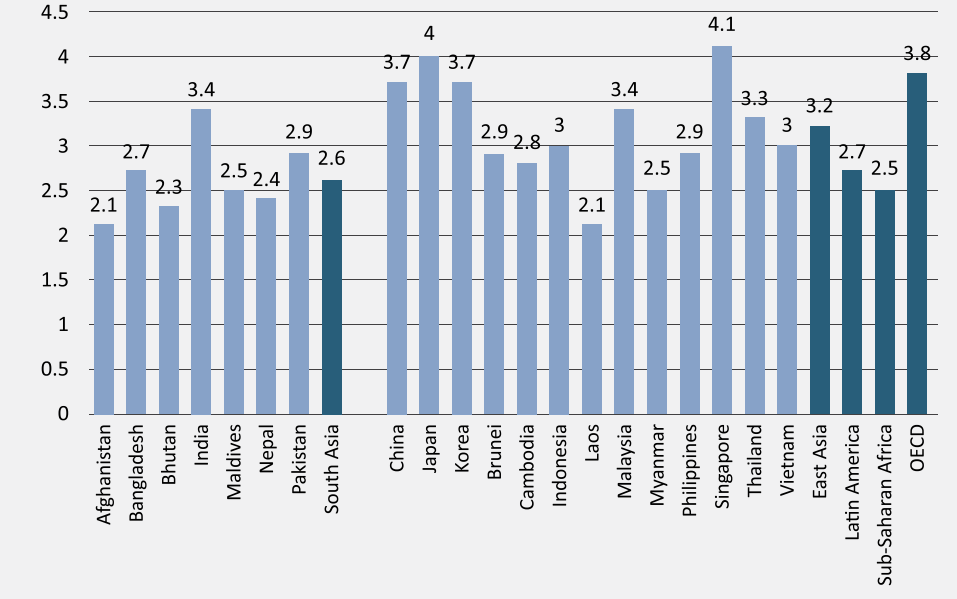
Source: World Bank, Doing Business 2018 / Notes: [1]Out of 190 countries. [2]Out of 189 countries.

Overall weaknesses in trade facilitation is captured by the logistics performance index calculated by the World Bank using perception-based indicators. These use surveys of operators, and the index ranges from 1 (lowest) to 5 (highest) focusing on several variables: customs performance, infrastructure, international shipments, logistics competence, tracking and tracing and timeliness. The LPI scores based on these indicators presented in Figure 5 show that, on average, SA is not only behind the OECD but also behind EA and Latin America. It is only ahead of Sub-Saharan Africa. However, India's LPI index is higher than the EA average and similar to that of Malaysia and Thailand. Similarly, Pakistan's LPI index is the same as the EA average.

The third component of SA's LEP2 should be to further deepen economic linkages with neighboring EA countries. SA countries should continue to sign bilateral and plurilateral FTAs and comprehensive economic partnership agreements with EA countries. India, the largest SA country, is already involved in negotiating the RCEP. Eventually other SA countries could follow suit and join it.[35] India should actively lobby and negotiate its participation in financial cooperation efforts in EA. Former Thai minister of finance Chalongphob Sussangkarn has proposed that India, Australia, and New Zealand be made associate members and contributing partners—short of full membership—of the Chiang Mai Initiative Multilateralization (CMIM), a $240 billion currency swap arrangement among ASEAN+3 countries.[36]

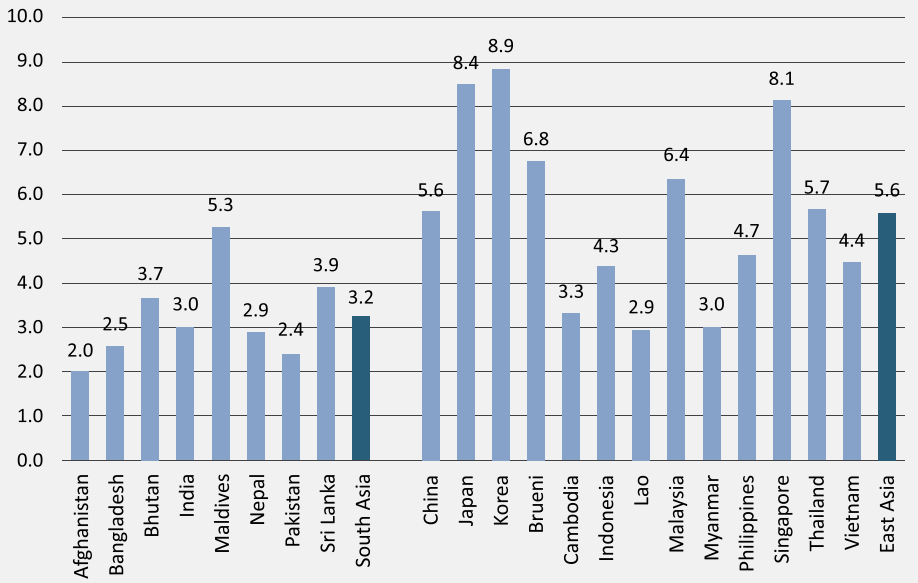
Fourth, SA countries should improve their ICT systems to coordinate supply chains efficiently. They should also promote e-commerce to transact and facilitate business on the internet. The ICT development index published by the International Telecommunication Union suggests that, although SA countries (especially Maldives and Sri Lanka) perform better than Cambodia, Laos, and Myanmar, they are way behind other EA countries. (Figure 5).

Figure 5: Logistic Performance Index (2016)



Source: World Bank[37]

Figure 6: ICT Development Index (2017)



Source: International Telecommunications Union.[38]

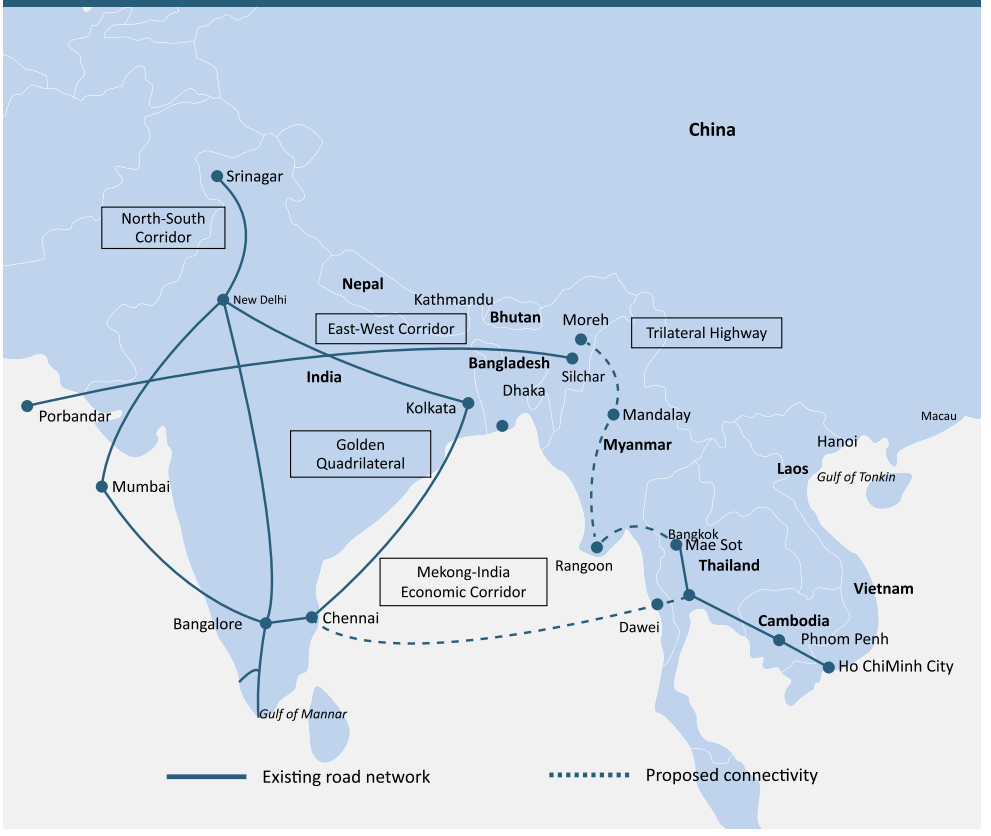
Fifth, SA countries should take steps to improve the quality of infrastructure within their region to reduce transport costs. Table 4 shows that on average the quality lags behind EA, standing at 3.7 compared to 4.6. Within SA, the quality is best in India and Bhutan and worst in Bangladesh and Nepal. SA countries should also support on-going efforts to enhance physical connectivity between these two regions, as this would reduce trading costs. The dominant mode of freight transport between SA and EA is ocean transport. However, other modes of transportation may also be viable for more sophisticated supply-chains, which require high value-added inputs on a timely basis. Two projects to link ASEAN to India, one a maritime/road and the other a road project, are at early stages of development and implementation (Figure 7).[39] These are the Mekong-India Economic Corridor (MIEC) and the Trilateral Highway connecting India with Myanmar and Thailand. While the major focus of the MIEC is to connect the automotive industry in Bangkok with that in Chennai, the Trilateral Highway seeks to develop the Northeast Region of India, which is lagging behind the rest of the country. The economic and industrial corridor to be established under the MIEC is to constitute state-of-the art transportation infrastructure such as expressways and high-speed railways that connect major industrial agglomerations.

In order to enhance connectivity between SA and EA, in addition to the ASEAN-India connectivity projects, it is also necessary to promote connectivity between China, ASEAN, and South Asia. One such project which needs to be supported is the BCIM Economic Corridor, which is one of the six land-based economic corridors under the BRI, for which a feasibility study has been completed. However, progress in this project is slow because of weak support from India. Another project is the circular Kunming/ Mandalay/ Dhaka/ Kolkota/ Kathmandu/ Lhasa/ Kunming Economic Corridor or the old Southwestern Silk Road.

Table 4: Quality of Infrastructure (2017)						
Country	**Quality of Overall Infrastructure**	**Road**	**Railroad**	**Port**	**Air Transport**	**Electricity Supply**
Bangladesh	2.9	3.1	2.9	3.6	3.3	3.7
Bhutan	4.3	4.1	N/A	2.0	4.1	5.8
India	4.6	4.3	4.4	4.6	4.6	4.7
Nepal	2.9	2.8	N/A	1.6	2.5	2.8
Pakistan	3.8	3.9	3.3	4.0	4.0	2.9
Sri Lanka	3.9	4.2	3.2	4.5	4.2	4.0
South Asia	3.7	3.5	3.5	3.4	3.8	4.0
East Asia	4.6	4.6	4.4	4.4	4.9	5.4

Notes: 1= worst possible situation; 7= best situation; NA=not available.
Source: World Economic Forum 2017

Figure 7: ASEAN-India Connectivity



Source: Kimura and Umezaki[40]

Conclusion

After over two centuries in the doldrums, in the post-1990 period traditional trade (that is, trade in final goods) between SA and EA has increased rapidly, albeit from a low base. This finding lends support to the view that we are witnessing the "re-emergence of Asia." Growing economic linkages between SA and EA can be explained mainly by the partial macroeconomic and structural reforms implemented by the SA countries and the LEP adopted either formally or informally in the 1980s and the 1990s. SA's participation in global production network trade (trade in parts and components) is, however, limited. SA countries need, therefore, to embark on LEP2 to link themselves to global production networks, especially those in EA (their largest potential market)[41] and develop production networks in their neighboring countries.

LEP2, together with LEP, will allow SA countries to benefit not only from the static complementarities associated with the traditional theories of international trade but also from the dynamic complementarities associated with the theory of product fragmentation.[42] Based mainly on the estimation results of a logit model, 5 sets of sometimes overlapping policies that SA countries should implement to further drive their economic integration with EA are identified. These include: 1) further improving the governance system and the business environment; 2) reducing logistics costs including trade facilitation "at the border"; 3) signing regional cooperation agreements with and joining regional trade and financial cooperation efforts in EA; 4) improving ICT; and 5) enhancing regional physical connectivity through hardware and software development.

Endnotes

[1] The author is grateful to the participants at the ISA panel where this paper was presented for their very useful comments.

[2] South Asia includes Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. East Asia includes the 10 ASEAN members plus China, Korea, and Japan

[3] Pradumna B. Rana, and Xianbi Ji, "The Asia-Pacific's Response to Rising U.S. Protectionism", Council of Councils Global Memo Series, Council on Foreign Relations, March 27, 2018.

[4] Pradumna B. Rana, and Xianbi Ji , "TPP's Resurrection: Will It be Ratified at All?" *Business Times*, November, 22 2017.

[5] For example, Malaysia has already said that it will not be able to ratify the CPTPP in early 2019.

[6] "Delhi Declaration of the ASEAN-India Commemorative Summit to mark the 25th Anniversary of ASEAN-India Dialogue Relations," http://asean.org/storage/2018/01/Delhi-Declaration_Adopted-25-Jan-2018.pdf.

[7] Joseph Francois, Pradumna B. Rana, and Ganeshan Wignaraja, eds., *National Strategies for Regional Integration: South and East Asian Case Studies* (London and Manila: Anthem Press and Asian Development Bank, 2009); Joseph Francois, Pradumna B. Rana, and Ganeshan Wignaraja, eds., *Pan-Asian Integration: Linking East and South Asia* (New York: Palgrave Macmillan, 2009); Asian Development Bank and Asian Development Bank Institute, *Connecting South Asia and East Asia* (Tokyo: Asian Development Bank Institute, 2015); Pradumna B. Rana and Wai-Mun Chia, *Jumpstarting South Asia: Revisiting Economic Reforms and Look East Policies* (Oxford: Oxford University Press, 2017).

[8] Modi unveiled India's Act East Policy in Myanmar at the ASEAN Summit on November 12 and reiterated it at the East Asia Summit on November 13, 2014, see Prashanth Parameswaran, "Modi Unveils India's Act East Policy to ASEAN in Myanmar," *The Diplomat*, November 17, 2014.

[9] Danielle Rajendram, "India's New Asia-Pacific Strategy: Modi Acts East," (Sydney: Lowy Institute for International Policy Paper, 2014).

[10] Joseph Francois, Pradumna B. Rana, and Ganeshan Wignaraja, eds., *National Strategies for Regional Integration*; Joseph Francois, Pradumna B. Rana, and Ganeshan Wignaraja, eds., *Pan-Asian Integration*.

[11] De uses an augmented gravity model and finds that East Asia has the greatest potential for trade with South Asia followed by the European Union, North America, and South Asia, see Prabir De, "South Asia: Trade Integration after the Global Crisis," International Bank for Reconstruction and Development Background Paper (Washington, DC: World Bank, 2010).

[12] R.W. Jones and Henryk Kierzkowski, "The Role of Services in Production and International Trade: A Theoretical Framework," in *The Political Economy of International Trade: Essays in Honor of Robert E Baldwin*, eds. R.W. Jones and Anne O. Krueger (Oxford: Blackwell, 1990); Funkunari Kimura and Mitsuyo Ando, "Two-dimensional Fragmentation in East Asia: Conceptual Framework and Empirics," *International Review of Economics and Finance* 14, no.3 (2005): 317-348.

[13] Pradumna B. Rana, ed., *Renaissance of Asia: Evolving Linkages between South Asia and East Asia* (Singapore: World Scientific Publishers, 2012); Ronald Findlay and Kevin O'Rourke, *Power and Plenty* (Princeton, NJ: Princeton University Press, 2007); Andre Gunder Frank, *ReOrient: Global Economy in the Asian Age* (Berkeley: University of California Press, 1998).

[14] Shashi Tharoor, *Inglorious Empire: What the British Did to India*. (London: C Hurst Co. Publishers, 2017).

[15] Shantayanan Devarajan and Ijaz Nabi, "Economic Growth in South Asia, Promising, Un-equalizing, Sustainable?" (Washington, DC: World Bank, 2006.)

[16] Danielle Rajendram, "India's New Asia-Pacific Strategy: Modi Acts East."

[17] Mohammad Shahidul Islam and Rumana Tashreen Khanam, "Trade Performance of Bangladesh with East: An Evaluative Study," *Asian Journal Management Sciences & Education* 3, no. 4 (2014): 1-18.

[18] Ahmad Malik, "Pakistan's Vision East Asia: Challenges and Opportunities," (Islamabad: Institute of Strategic Studies, 2015).

[19] Pradumna B. Rana and Wai-Mun Chia, *Jumpstarting South Asia*.

[20] International Monetary Fund, "Trade Interconnectedness: The World with Global Value Chains," Washington DC, August 28, 2013, available at http://www.imf.org/external/np/pp/eng/2013/082613.pdf.

[21] The terms production networks, supply-chains, and global value chains (GVCs) are similar and are used interchangeably in this paper.

[22] Ganeshan Wignaraja, Jens Kruger, and Anna Mae Tuazon, "Production Networks, Profits, and Innovative Activity: Evidence from Malaysia and Thailand," ADBI Working Paper Series No. 416 (Tokyo: Asian Development Bank Institute, 2013).

[23] Two standard approaches used to analyze the importance of production networks are: a country's share of world trade in parts and components using Athukorala's approach and the GVC participation index based on value-added data published by UNCTAD. The first approach is constrained by the ad hoc nature of classification of industries and availability of data. Hence, the second approach is used. It is also more intuitive as it avoids double-counting. See Prema-chandra Athukorala, "Production Networks and Trade Patterns in East Asia: Regionalization or Globalization?" ADB Working Paper Series No. 56 (Manila: Asian Development Bank, 2010).

[24] Prabir De, "South Asia: Trade Integration after the Global Crisis."

[25] Using firm level data from Malaysia and Thailand, which are important participants in East Asia's production network, Ganeshan Wignaraja, Jens Kruger, and Anna Mae Tuazon, "Production Networks, Profits, and Innovative Activity," have found that participation in production networks raises profits and is also associated with technological upgrading and higher research and development expenditures. Over time, production networks have also deepened and spread from electronics to other sectors such as automobiles, televisions, and cameras. See Amy Jocelyn Glass, and Kamal Saggi, "Innovation and wage effects of international outsourcing," *European Economic Review* 45, no. 1 (2001): 67-86.

[26] Pradumna B. Rana and Wai-Mun Chia, *Jumpstarting South Asia*.

[27] Stephen S. Golub, Ronald W. Jones, and Henryk Kierzkowski, "Globalization and Country-specific Service Link," *Journal of Economic Policy Reform* 10, no. 2 (2007): 63-88.

[28] Prema-chandra Athukorala, "Production Networks and Trade Patterns in East Asia"; Prema-chandra Athukorala and Jayant Menon, "Global Production Sharing, Trade Patterns, and Determinants of Trade Flows in East Asia," ADB Working Paper Series No. 41 (Manila: Asian Development Bank, 2010).

[29] A more appropriate proxy of the degrees to which business environments are conducive to foreign investors are the World Bank's ease of doing business indicators. However, for most countries in the dataset, the surveys are available only from 2010 onwards.

[30] Since the samples include eight South Asian countries and ten ASEAN + 3 countries, the dummy of East Asia needs to be dropped from the specification due to perfect collinearity.

[31] G. S. Maddala, *Limited Dependent and Qualitative Variables in Econometrics* (Cambridge, MA: Cambridge University Press, 1983); Leslie E. Papke and Jeffrey M. Wooldridge, "Econometric Methods for Fractional Response Variables with an Application to 401(K) Plan Participation Rates," *Journal of Applied Econometrics* 11, no. 6 (1996): 619-32.

[32] Stephen S. Golub, Ronald W. Jones, and Henryk Kierzkowski, "Globalization and Country-specific Service Link," 63-88.

[33] Since the other estimation results for the two components were similar in the case of other variables, they are not presented in the paper.

[34] In the absence of second-generation reforms, private-sector-led growth in SA countries due to macroeconomic reforms of the 1980s and the 1990s could run out of steam and not be sustained because of, among other reasons, corruption and absence of the rule of law or of clear property rights.

[35] Joseph Francois, Pradumna B. Rana, and Ganeshan Wignaraja, eds., *Pan-Asian Integration*.

[36] Chalongphob Sussangkarn, "The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook," Asian Development Bank Institute, Working Paper Series No. 230, 2010.

[37] World Bank, "Connecting to Compete 2016: Trade Logistics in the Global Economy," (Washington, DC: The International Bank for Reconstruction and Development, World Bank, 2016.)

[38] International Telecommunications Union, "Measuring the Information Society Report," https://www.itu.int/en/ITUD/Statistics/Documents/publications/misr2017/MISR2017_Vol. 1.pdf, 2017.

[39] At the sub-regional level, the Bangladesh-Bhutan-India-Nepal (BBIN) initiative has also shown encouraging progress. Although its scope covers other broad areas such as water resource management, the BBIN's most successful project has been the BBIN Motor Vehicle Agreement which has simplified the procedures for the movement of passenger vehicles among the three countries (Bangladesh, India, and Nepal) that have signed the agreement so far. The MVA needs to be expanded to other neighboring countries.

[40] Fukunari Kimura and So Umezaki, "ASEAN-India Connectivity: The Comprehensive Asia Development Plan, Phase II," ERIA Research Project Report No.7, (Jakarta: Economic Research Institute for ASEAN and East Asia, 2010); Resource and Information System for Developing Countries, "ASEAN-India Connectivity Report: India Country Study," (New Delhi: Bookwell 2012).

[41] Prabir De, "South Asia: Trade Integration after the Global Crisis."

[42] R.W. Jones and Henryk Kierzkowski, "The Role of Services in Production and International Trade"; Funkunari Kimura and Mitsuyo Ando, "Two-dimensional Fragmentation in East Asia," 317-48.