

Wignaraja, Ganeshan

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## Assessing the experience of South Asia-East Asia integration and India's role

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**ADB Working Paper Series**

**Assessing the Experience of  
South Asia–East Asia Integration  
and India’s Role**

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Ganeshan Wignaraja

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Please contact the author for information about this paper.

E-mail: [gwignaraja@adbi.org](mailto:gwignaraja@adbi.org)

Asian Development Bank Institute  
Kasumigaseki Building 8F  
3-2-5 Kasumigaseki, Chiyoda-ku  
Tokyo 100-6008, Japan

Tel: +81-3-3593-5500

Fax: +81-3-3593-5571

URL: [www.adbi.org](http://www.adbi.org)

E-mail: [info@adbi.org](mailto:info@adbi.org)

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**Abstract**

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

**JEL Classification:** F15, F17, O14, O24, O53

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## 1. INTRODUCTION

There is heightened policy interest in pan-Asian economic integration, particularly between South and East Asian economies.<sup>1</sup> India's Look East Policy of 1991 signaled the intent of South Asia's giant economy to revitalize the civilizational, defense, and economic ties with globally important East Asia (Asher and Sen 2008). India has a plurilateral free trade agreement (FTA) with the Association of Southeast Asian Nations (ASEAN) as well as bilateral FTAs with Japan, the Republic of Korea, and Singapore (Nataraja 2010; Francis 2011). Negotiations are also under way for the large regional comprehensive economic partnership (RCEP) involving India, East Asian economies, Australia, and New Zealand (Chia 2013).

The process of pan-Asian economic integration has sparked a growing public debate about its impacts for insiders and outsiders. This paper addresses two related policy questions in this debate: Will South Asian economies benefit from integrating with East Asia? And, are there economic grounds for India to include its South Asian neighbors in the process? This paper seeks to improve our understanding of the economic implications of pan-Asian integration, particularly for South Asia, and contribute to the sparse academic literature on South Asia–East Asia integration.<sup>2</sup> It analyzes trade and foreign direct investment (FDI) flows, maps FTA activity, explores impediments to pan-Asian integration, and discusses the results of a quantitative assessment of several policy scenarios.

Section 2 examines regional patterns of trade, FDI, and FTAs. Section 3 discusses impediments to pan-Asian integration. Section 4 examines the broad economic effects of various policy scenarios on India and other South Asian economies. Section 5 concludes.

## 2. REGIONAL PATTERNS OF TRADE, FOREIGN DIRECT INVESTMENT, AND FREE TRADE AGREEMENTS

### 2.1 A Shift in Regional Integration Priorities

For convenience, two distinct periods can be identified in South Asia–East Asia economic integration: (i) an era of limited regional integration from about 1945 until the late 1980s; and (ii) an era of intensifying efforts at regional integration from 1990 until the present. These two periods are briefly discussed, followed by an examination of post-1990 trends in trade, FDI, and FTAs.

Before 1990, South and East Asian economies were relatively isolated from one another in terms of economic relations (Rana and Dowling 2009). There was limited bilateral trade and investment flows in goods or services. There was also little talk in policy circles of pan-Asian integration using active regional integration policies. The only trade agreement that covered the two subregions was the Bangkok Agreement

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<sup>1</sup> South Asia is defined here to include the eight South Asian Association for Regional Cooperation members (Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka). East Asia consists of the 10 Association of Southeast Asian Nations member states, the People's Republic of China, Japan, and the Republic of Korea.

<sup>2</sup> For a recent selection, see Kumar, Sen, and Asher (2006); Kumar, Kesavapany, and Chaocheng (2008); Francois, Rana, and Wignaraja (2009b, 2009c); and ADB and ADBI (2013).

(now called the Asia-Pacific Trade Agreement) signed in 1975.<sup>3</sup> The relative isolation between the two subregions before 1990 stems from a lack of political signals to foster South Asia–East Asia integration, barriers to regional trade and investment, poor regional connectivity, and cultural and linguistic barriers.

After the Second World War, South and East Asia viewed the benefits of globalization differently and followed different development strategies. The economic performance of the two Asian subregions has differed and the incentive for closer regional integration between them. Following independence from British rule in 1947, India and Pakistan adopted import-substituting industrialization strategies with high import tariffs, licensing to control entry into industries, and other forms of state intervention. The private sector and exports in India and Pakistan were shackled an anti-export bias in the trade regime. Influenced by prevailing anti-globalization economic philosophy, the smaller South Asian economies, to varying degrees, also adopted a similar development strategy. Growth and trade in inward-oriented South Asia thus largely stagnated.

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

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

First, South Asian economies have adopted more market-friendly trade and investment regimes through a gradual implementation of economic reforms. Sri Lanka was the earliest South Asian economy to start a reform process in 1977. Popular discourse often equates India's reforms, especially of trade and investment policies with the post-1991 period. Partial reforms of trade policy, however, were initiated in the previous decade. The other South Asian economies initiated reforms only in the 1980s and 1990s.

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

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

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<sup>3</sup> This agreement covers Bangladesh, the People's Republic of China, India, the Republic of Korea, the Lao People's Democratic Republic, and Sri Lanka.

Fourth, there has been a proliferation of FTAs involving the two subregions in an attempt to liberalize intra-Asian trade and provide more clarity of the rules governing such trade. As will be further discussed later, these agreements are partly a result of India's Look East Policy as well as increasing recognition of the business opportunities from a relatively large South Asian market.

## 2.2 Regional Trade Patterns

These factors have supported the growth of regional trade since 1990, albeit from a relatively low base. As Table 1 shows, South Asian exports to East Asia (in US dollars terms) grew rapidly at 13.7% per year between 1990 and 2012, while imports from East Asia grew at a comparable rate (14.2%). The value of total trade between South and East Asia amounted to around US\$229.3 billion in 2012 (up from US\$12.7 billion in 1990). South Asia's larger economies account for the bulk of the growing trade with East Asia. India (which makes up 78.4% of the value of South Asia's trade with East Asia) saw double-digit growth in trade relations with East Asia. Bangladesh, Pakistan, and Sri Lanka have also experienced growth in trade relations with East Asia, particularly imports, but exports have lagged. The economies of the region's smaller least developed countries (Afghanistan, the Maldives, and Nepal) are at the early stages of trade relations with East Asia.

**Table 1: Growth in South Asia's Trade with East Asia, 1990–2012**

	Exports (US\$ million)			Imports (US\$ million)		
	1990	2000	2012	1990	2000	2012
<b>South Asia</b>	3,955	7,441	66,059	8,737	17,796	163,261
India	2,597	5,732	59,243	3,781	8,835	120,546
Pakistan	984	1,076	4,868	2,040	2,643	18,811
Bangladesh	155	168	1,160	1,299	3,177	14,446
Sri Lanka	187	431	692	929	2,365	5,308
Nepal	14	14	50	302	398	2,471
Maldives	16	11	40	97	188	623
Afghanistan	3	9	6	289	191	1,055
	Annual Average Growth in Exports (%)			Annual Average Growth in Imports (%)		
	1990–2012	1990–2000	2000–2012	1990–2012	1990–2000	2000–2012
<b>South Asia</b>	13.7	6.5	20.0	14.2	7.4	20.3
India	15.3	8.2	21.5	17.0	8.9	24.3
Pakistan	7.5	0.9	13.4	10.6	2.6	17.8
Bangladesh	9.6	0.9	17.5	11.6	9.4	13.5
Sri Lanka	6.1	8.7	4.0	8.2	9.8	7.0
Maldives	4.4	-3.5	11.5	8.8	6.9	10.5
Nepal	6.0	0	11.2	10.0	2.8	16.4
Afghanistan	3.9	12.5	-2.8	6.1	-4.1	15.3

Notes: No data for Bhutan; East Asia refers to the 10 Association of Southeast Asian Nations member states, the People's Republic of China, Japan, and the Republic of Korea.

Source: International Monetary Fund Direction of Trade Statistics.

There has been a shift in South Asia's trade shares toward East Asia. As shown in Table 2, the share of South Asia's exports to East Asia increased from 14.5% to 18.5% between 1990 and 2012 and the share of imports from 22.5% to 26.7%. Underlying this shift is a significant realignment of India toward East Asia, which accounts for one-fifth



of India's exports and a quarter of its imports (2012). Pakistan has also increased its trade with East Asia, which makes up one-fifth of exports and one-third of imports. However, the rest of South Asia shows varying degrees of trade orientation toward East Asia. India's experience suggests that trade with East Asia offers South Asian economies a potentially dramatic enlargement of their economic horizons, making available a far greater regional market with which they can integrate.

**Table 2: Trade Shares of South Asia, 1990, 2000, and 2012**  
(%)

	East Asia			European Union			United States			Rest of the World		
	1990	2000	2012	1990	2000	2012	1990	2000	2012	1990	2000	2012
<b>Exports, share of total</b>												
<b>South Asia</b>	14.5	11.7	18.5	31.3	26.6	18.9	16.3	24.5	12.8	37.9	37.2	49.8
India	14.6	13.4	19.9	28.9	24.4	16.7	15.1	21.3	12.2	41.4	40.9	51.2
Pakistan	17.6	12.1	19	37.8	27.9	18.2	12.4	25.2	13.6	32.2	34.7	49.2
Bangladesh	9.3	3	5.2	35.3	40.3	45.4	30.5	31.8	16.6	24.9	24.9	32.7
Sri Lanka	9.9	7.9	6.8	27.5	28.3	29.3	25.9	40.2	20.4	36.8	23.7	43.4
Maldives	30.1	14.4	19.2	26.2	18.6	49.3	24.2	44.2	9.4	19.5	22.8	22.2
Nepal	6.6	1.9	5.7	53.3	23	11.6	23.4	27.5	9.3	16.7	47.6	73.4
Afghanistan	2	6	1.2	61.8	35.3	10	3.4	1.9	6.2	32.8	56.9	82.6
<b>Imports, share of total</b>												
<b>South Asia</b>	22.5	22.4	26.7	29	18.2	10.6	10.3	5.4	4.8	38.3	53.9	57.8
India	15.8	17.6	24.6	33.7	21.3	11.1	11	6.3	5.1	39.6	54.9	59.2
Pakistan	27.6	24.7	36.4	25.1	15.5	10.4	12.8	6.1	3.3	34.4	53.8	50
Bangladesh	35.5	35.3	42.3	18.9	9.7	5.7	5.1	2.4	1.7	40.5	52.6	50.3
Sri Lanka	35.2	35.4	31.1	16.6	14.4	10.2	7.9	3.8	1.3	40.3	46.4	57.3
Maldives	70.1	48.3	44.1	13	9.6	8.3	0.5	2.2	2.3	16.4	39.8	45.3
Nepal	51.5	25.3	38.4	18.6	7.3	2.1	2.4	1.6	0.6	27.5	65.8	58.9
Afghanistan	60.4	30.7	11.6	14.9	10	12.7	1	2	18	23.7	57.3	57.7

Notes: No data for Bhutan; East Asia refers to the 10 Association of Southeast Asian Nations member states, the People's Republic of China, Japan, and the Republic of Korea.

Source: International Monetary Fund Direction of Trade Statistics.

A striking shift is also visible within the destination of South Asia's trade with East Asia. Reflecting global trends, Japan has declined in importance as an export destination for South Asian exports while the PRC has become its largest export destination. The Republic of Korea and ASEAN economies have also become more important. The share of South Asia's exports destined for Japan fell from 58.5% to 10.9% between 1990 and 2012. Meanwhile the share of the PRC rose from 1.2% to 27.9%, Singapore from 15.6% to 21.9%, Indonesia from 3.6% to 10.2%, the Republic of Korea from 5.9% to 7.1%, and Viet Nam from 0.7% to 6.4%.

The commodity composition of trade between South and East Asian economies tends to reflect inter-country differences in comparative advantages<sup>4</sup> (natural resources, capital, labor, and technology) and levels of economic development. With an abundance of natural resources and labor, South Asia's exports to East Asia are

<sup>4</sup> Analyses of revealed comparative advantages at the product level in South and East Asian trade are contained in Scollay and Pelkmans-Balaoing (2009) and Dasgupta, Pitigala, and Gourdon (2012). These studies conclude that South Asian countries exhibit a relatively narrow range of comparative advantages compared to the economies of East Asia.

weighted toward such products. Meanwhile, South Asia's imports from East Asia mainly consist of finished and high-technology goods reflecting an abundance of capital and technology. To illustrate this pattern of trade, Table 3 provides the leading items in India's trade with East Asia since 1991. India's main exports to East Asia include natural resource-intensive products (iron ore, mineral fuels, pearls, and stones), cotton, fish, non-ferrous metals and ores, granite, leather, oil cake, beef, and crustaceans, as well as some skill and technology-intensive goods (chemicals, plastics, and machinery). In contrast, East Asia's leading exports to South Asia feature products such as computers and integrated circuits; TV, radio, and telecommunications equipment; motor vehicles and motor vehicle parts; and antibiotics. Where there is two-way trade in the same industry, East Asian exports tend to be at a higher level of processing. For the steel industry, India's leading exports to East Asia include ferro-alloys, pig iron, and rolled steel; East Asia's leading exports to South Asia include rolled steel of a heavier grade.

**Table 3: India's Top 10 Traded Commodities with East Asia**  
(percentage share of total exports and total imports)

Commodity Code	Commodity Description	2000	2012
<b>Share of total exports</b>			
27	Mineral fuels, mineral oils, and products of their distillation	0.0	8.1
71	Natural or cultured pearls, precious or semi-precious stones, precious metals	17.5	6.8
52	Cotton	4.6	2.5
29	Organic chemicals	1.0	2.1
26	Ores, slag, and ash	8.0	1.7
89	Ships, boats, and floating structures	0.0	1.3
74	Copper and articles thereof	0.1	1.2
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	0.1	1.2
72	Iron and steel	0.1	1.0
10	Cereals	0.1	1.0
<b>Share of total imports</b>			
85	Electrical machinery and equipment, and parts thereof	10.6	15.8
84	Nuclear reactors, boilers, machinery, and mechanical appliances	13.4	15.0
27	Mineral fuels, mineral oils, and products of their distillation	5.7	9.5
71	Natural or cultured pearls, precious or semi-precious stones, precious metals	0.5	6.8
29	Organic chemicals	3.9	6.3
15	Animal or vegetable fats and oils	4.5	6.2
72	Iron and steel	6.8	4.1
39	Plastics and articles thereof	3.7	3.1
89	Ships, boats, and floating structures	2.7	3.0
87	Vehicles other than railway or tramway rolling-stock	2.2	6.4

Source: United Nations Comtrade Database.

## 2.3 Regional Foreign Direct Investment Patterns

Data on FDI flows between South and East Asia are problematic. Official data on regional FDI flows are not available from international sources while national data are patchy and not comparable. A private company, fDi Markets, provides regional data on

greenfield investments<sup>5</sup> from 2003 onward that suggests that FDI flows between South and East Asia have nearly doubled but from a low base. According to fDi Markets, the value of total FDI between South and East Asia amounted to US\$9.2 billion in 2012 (up from US\$5.0 billion in 2003). Interestingly, regional FDI flows in 2012 are much smaller than regional trade flows despite the recent improvement. The costs and risks of setting up new plants abroad (or expanding existing plants) are higher than those relating to trading from home.

FDI flows from less developed South Asia to more developed East Asia are lower than the flow the other way. As Table 4 shows, annual flows of FDI from South Asia to East Asia were only about US\$5 billion in 2003–2012. Meanwhile, FDI flows from East Asia to South Asia were more than double at over US\$11 billion.

**Table 4: Foreign Direct Investment Flows of South Asia, 2003–2012**  
(US\$ million)

	East Asia to South Asia			South Asia to East Asia		
	Annualized Average 2003–2012	Cumulative 2003–2012	Share (%)	Annualized Average 2003–2012	Cumulative 2003–2012	Share (%)
<b>South Asia</b>	11,838	106,542	100.0	4,970	42,024	100.0
India	9,983	89,851	84.3	4,939	41,730	99.3
Pakistan	919	8,268	7.8	13	165	0.4
Bangladesh	146	1,312	1.2	10	93	0.2
Sri Lanka	224	2,016	1.9	8	35	0.1
Maldives	161	1,452	1.4	n.a.	n.a.	n.a.
Nepal	25	223	0.2	0	1	0.0 <sup>a</sup>
Afghanistan	380	3,421	3.2	0	0	0.0 <sup>a</sup>

n.a. = not available.

Notes:

<sup>a</sup> negligible.

Figures cover only greenfield investments.

fDi Markets defines “greenfield investments” as cross-border investments in a new physical project or expansion of an existing investment which creates new jobs and capital investment. Joint ventures are only included where they lead to a new physical operation. Mergers and acquisitions and other equity investments are not tracked. There is no minimum size for a project to be included.

Source: fDi Markets (accessed 7 February 2014). <http://www.fdimarkets.com>

Cumulative FDI flows from East Asia to South Asia in 2003–2012 were US\$11.8 billion. In contrast to trade flows, Japan (with 36.1% of cumulative FDI inflows in 2003–2012) is the leading foreign investor in South Asia. The Republic of Korea (20.6%) and the PRC (18.7%) come next. Singapore (11.0%) and Malaysia (10.7%) follow some way behind. Nataraja (2010) argues that Japanese inward investment to India is below potential, reflecting a hesitation among Japanese multinational corporations (MNCs) with regard to India.<sup>6</sup> The explanation is said to lie in constraints in India’s investment

<sup>5</sup> fDi Markets defines greenfield investments as cross-border investment in a new physical project or expansion of an existing investment that creates new jobs and capital investment. Joint ventures are included where they lead to a new physical operation. However, mergers and acquisitions as well as other equity investments—generally the largest element of FDI inflows—are not tracked by fDi Markets. Hence, the data in Table 4 are likely to understate the magnitude of investment flows between South and East Asia.

<sup>6</sup> Case studies of Japanese subsidiaries or joint ventures in India by Roy Choudhury (2009) suggest that in the telecommunications and pharmaceuticals sectors, India has become a potential destination for research and development activity because of its relatively cheap but highly qualified technical human

climate, such as poor infrastructure, strict labor laws, and cumbersome business procedures. These issues will be explored further in Section 4.

As with trade flows, the giant Indian economy dominates regional FDI flows. India accounted for 99.4% of cumulative FDI flows from South Asia to East Asia in 2003–2012 and 84.7% of cumulative FDI flows from East Asia to South Asia. Other South Asian economies have invested little in East Asia but have received some East Asian FDI. Pakistan notably accounts for 7.4% of cumulative FDI flows from East Asia to South Asia.

The distribution of cumulative FDI flows between India and East Asia by major sectors during 2003–2012 is provided in Table 5. FDI inflows from East Asia to India are in a diversified range of economic sectors. The largest FDI activity is automotive original equipment manufacturer (OEM) and parts (22.2%). This is followed by metals (18.2%); real estate (6.2%); communications (4.0%); consumer electronics (4.0%); engines and turbines (4.0%); industrial machinery, equipment, and tools (3.9%); and semiconductors (3.9%). Meanwhile, India's outflows of FDI to East Asia are concentrated in resource activities (34.0% in metals and 14.1% in coal, oil, and gas) and service activities (10.3% in financial services, 8.5% in software and information technology [IT] services, 2.2% in transportation, and 2.2% in hotels and tourism).

**Table 5: India and East Asia Foreign Direct Investment Inflows by Major Sectors**  
(US\$ million)

Industry Sectors	Cumulative 2003–2013	Share of Total (%)
<b>Foreign direct investment inflows from East Asia to India</b>		
Automotive original equipment manufacturer (OEM)	20,886	22.2
Metals	17,092	18.2
Real estate	5,793	6.2
Communications	3,777	4.0
Consumer electronics	3,747	4.0
Engines and turbines	3,732	4.0
Industrial machinery, equipment, and tools	3,701	3.9
Semiconductors	3,671	3.9
Coal, oil, and natural gas	3,472	3.7
Automotive components	3,384	3.6
<b>Foreign direct investment outflows from India to East Asia</b>		
Metals	14,982	34.0
Coal, oil, and natural gas	6,220	14.1
Financial services	4,530	10.3
Software and information technology services	3,727	8.5
Automotive OEM	3,205	7.3
Rubber	1,192	2.7
Transportation	962	2.2
Hotels and tourism	952	2.2
Chemicals	918	2.1
Business services	895	2.0
Pharmaceuticals	760	1.7

Note: Figures cover only greenfield investments.

Source: fDi Markets (accessed 17 February 2014). <http://www.fdimarkets.com>

resources. Furthermore, Japanese firms value trust in their partner and each of the firms that has a joint venture in India spent a long time deciding on the partnership.

## 2.4 Regional Patterns of Free Trade Agreements

Growing trade and investment integration between South and East Asia since 1990 has been accompanied by heightened FTA activity to foster preferential trade liberalization. Table 6 lists South Asia–East Asia FTAs by status as of December 2013. Before 1990, there was only one FTA linking South and East Asian economies (the 1976 Asia-Pacific Trade Agreement or APTA). By December 2013, nine FTAs were in effect between South and East Asian countries, with eight taking effect since 2004. Another 14 FTAs are either signed and waiting implementation, under negotiation, or proposed.

**Table 6: Free Trade Agreements between South and East Asia**

Before 1990	Up to 2012	In the pipeline
1	9	14
<ul style="list-style-type: none"> <li>• Asia-Pacific Trade Agreement (1976)</li> </ul>	<ul style="list-style-type: none"> <li>• Asia-Pacific Trade Agreement (1976)</li> <li>• India–Thailand Free Trade Area (2004)</li> <li>• India–Singapore Comprehensive Economic Cooperation Agreement (2005)</li> <li>• PRC–Pakistan Free Trade Agreement (2007)</li> <li>• Malaysia–Pakistan Closer Economic Partnership Agreement (2008)</li> <li>• ASEAN–India Comprehensive Economic Cooperation Agreement (2010)</li> <li>• India–Republic of Korea Comprehensive Economic Partnership Agreement (2010)</li> <li>• Japan–India Comprehensive Economic Partnership Agreement (2011)</li> <li>• Malaysia–India Comprehensive Economic Cooperation Agreement (2011)</li> </ul>	<p><i>Signed but not yet in effect (2)</i></p> <ul style="list-style-type: none"> <li>• Preferential Tariff Arrangement-Group of Eight Developing Countries (2006)</li> <li>• Pakistan–Indonesia Free Trade Agreement (2012)</li> </ul> <p><i>Under negotiation (5)</i></p> <ul style="list-style-type: none"> <li>• Trade Preferential System of the Organization of the Islamic Conference (2004)</li> <li>• Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area (Framework Agreement signed in 2004)</li> <li>• Pakistan–Singapore Free Trade Agreement (2005)</li> <li>• India–Indonesia Comprehensive Economic Cooperation Arrangement (2011)</li> <li>• Regional Comprehensive Economic Partnership (RCEP) (2012)</li> </ul> <p><i>Proposed (7)</i></p> <ul style="list-style-type: none"> <li>• PRC–India Regional Trading Arrangement (2003)</li> <li>• Comprehensive Economic Partnership Agreement between Singapore and Sri Lanka (2003)</li> <li>• Pakistan–Philippines Free Trade Agreement (2004)</li> <li>• Pakistan–Thailand Free Trade Agreement (2004)</li> <li>• Comprehensive Economic Partnership for East Asia (CEPEA/ASEAN+6) (2005)</li> <li>• Pakistan–Brunei Darussalam Free Trade Agreement (2007)</li> <li>• ASEAN–Pakistan Free Trade Agreement (2009)</li> </ul>

ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China.

Source: Asia Regional Integration Center ([www.aric.adb.org](http://www.aric.adb.org)) Free Trade Agreement database (data as of 31 December 2013).

Not surprisingly, the two largest economies with better competitive advantages, stronger business lobbies, and better trade negotiations capacity lead South Asia's FTA activity with East Asia. India is a party to two plurilateral agreements (APTA and the ASEAN–India Comprehensive Economic Cooperation Agreement), bilateral

agreements with three ASEAN economies, and bilateral agreements with Japan and the Republic of Korea. The framework agreement for the ASEAN–India FTA was signed in October 2003 with the aim of eventually achieving an agreement covering goods, services and investment. The ASEAN–India Trade in Goods Agreement took effect in January 2010 after several years of negotiations. In December 2012, India and ASEAN concluded negotiations for agreements on services and investment.

Pakistan has bilateral FTAs with Malaysia and the PRC. Pakistan has also signed a bilateral agreement with Indonesia and is negotiating another with Singapore. A Sri Lanka–Singapore FTA has been proposed with little sign when negotiations would commence. In February 2014, Sri Lanka also announced an ambitious target of concluding an FTA with the PRC by the end of 2014. However, other South Asian economies do not have any FTAs with East Asia.

Recent FTAs to shape South Asia–East Asia economic ties were motivated by India's Look East Policy and its desire to promote economic ties with economically vibrant East Asian economies. Japan, the Republic of Korea, and some ASEAN economies also see merits in promoting ties with the large Indian economy to reap the benefits of the large Indian market and to balance the global influence of a rising PRC. A mix of political and economic motives underlies Pakistan's FTA with the PRC and its bilateral agreements with ASEAN economies. Furthermore, extended delays in the WTO Doha Round trade talks have spurred the growth in South Asia–East Asia FTAs with Asian economies seeking increased market access and reduction in behind-the-border regulatory barriers.

Beyond East Asia, some South Asian countries are involved in FTA negotiations with major trading partners. India has been involved in FTA negotiations with the EU since 2007. However, there is little sign of even a feasibility study for an India–US FTA. Pakistan and Sri Lanka had some initial discussions with the US. These seem early days in such cross-regional trading arrangements.

### **3. KEY IMPEDIMENTS TO PAN-ASIAN INTEGRATION**

While the pace of South Asia–East Asia economic integration has picked up since 1990, a myriad of impediments at regional and national levels remain, which can hamper the process.<sup>7</sup> Four key impediments are (i) gaps in cross-border infrastructure, (ii) a risk of insufficient depth and business use of FTAs, (iii) trade barriers and cumbersome business procedures, and (iv) barriers to services trade. The remainder of this section discusses these impediments and explores policy implications.

#### **3.1 Gaps in Cross-Border Infrastructure**

There is little doubt that Asia's trade performance and its ability to attract inward investment depend fundamentally on efficient, reliable, and seamless infrastructure (ADB and ADBI 2009). The spread of global supply chains in East Asia driven by MNCs means that manufacturing activities have been dispersed over geographical space connected by trade in parts, components, and services. India has gradually been incorporated into global supply chains through inward investment from Japan, the Republic of Korea, and ASEAN economies. The changing structure of global supply

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<sup>7</sup> For a more detailed discussion of these and other impediments to pan-Asian integration, see the papers in Francois, Rana, and Wignaraja (2009b, 2009c), as well as ADB and ADBI (2013). The papers in Ahmed, Kelegama, and Ghani (2010) examine impediments to integration within South Asia.

chains are expected to have a significant effect on trade and investment flows between South and East Asia. Investment in cross-border infrastructure, multimodal transport systems and logistics are critical to facilitate South Asia–East Asia supply chain integration.

Detailed technical studies of infrastructure connectivity assess different transport options to efficiently and seamlessly integrate South and East Asia trade (Arnold 2009; ADB and ADBI 2013). These studies have also identified several missing links and bottlenecks—particularly in sea and land transport—in connectivity between South and East Asia. They find that the dominant mode for freight transport between South and East Asia remains ocean transport and this situation is expected to continue for the foreseeable future. International shipping lines serving the South Asia–East Asia region operate on the equatorial route connecting East Asia and the Persian Gulf and the Mediterranean. The introduction of larger container ships and expansion of feeder services have supported trade growth. However, problems have been identified in the facilities and operational efficiency of public ports (such as Chittagong Port in Bangladesh, Kolkata Port in India, and Yangon Port in Myanmar) and links between ports and road networks.<sup>8</sup>

Furthermore, it is suggested that the recent opening up of Myanmar through political and economic reforms means that land transport (both road and rail) will have an increasing role in bilateral trade within Asia, but major improvements are needed (ADB and ADBI 2013). New land corridors between India and the PRC through Bhutan and Nepal are required, necessitating large investments. For instance, a minimum investment of US\$18 billion is needed for road creation and improvement totaling 26,000 kilometers of roads to complete the Asian Highway project. Land access to ports is also important for landlocked countries. With respect to the intra-regional rail network, the Trans-Asian Railway (TAR) network includes about 10,500 kilometers of missing links that need to be constructed to provide for an unbroken TAR network. Moreover, the incompatibility of gauges (track widths) in India, Bangladesh, Thailand, and Myanmar means that transshipment will be required even after through rail links are developed. Air transport is growing in importance as the value of commodities traded between the two regions increases; however, the growth in air freight has lagged behind that of ocean transport and is likely to continue to do so.

Inter-country comparisons of the quality of infrastructure are difficult due to measurement problems, statistical gaps, and the inherently subjective nature of such evaluations (ADB and ADBI 2009). Table 7 provides one such evaluation from the World Economic Forum (WEF) Global Competitiveness Report 2013–2014. The evaluation is based on a survey of global business leaders' perceptions and available hard data indicators on ports, roads, railways, and air transport. A value of 7 in the scoring system used shows the best possible situation and 1 the worst. The data suggest that the quality of infrastructure in South Asian economies typically lags behind East Asian economies. In terms of the quality of overall infrastructure, South Asia's largest economies fare poorly: India has a value of 3.9, Pakistan 3.3, and Bangladesh 2.8. Sri Lanka (4.8) and Bhutan (4.9) are exceptions in South Asia. By comparison, the Republic of Korea has a value of 5.6, Malaysia 5.5, and the PRC 4.3. Interestingly, the Philippines and Viet Nam underperform in East Asia.

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<sup>8</sup> In Chittagong Port, the size of vessels that are able to call is limited by the width and curvature of the Karnaphuli River. Rail and road traffic between Chittagong Port and Dhaka also created severe bottlenecks. Yangon Port also has several problems, including limited accessibility to large vessels, poor road conditions between the Thilawa port area and the bridge leading to Yangon, high container charges, obsolete facilities in Yangon port, frequent blackouts and insufficient generators, and lack of cargo equipment (see ADB and ADBI 2013).

**Table 7: Quality of Infrastructure, 2013**

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

n.a. = not available, PRC = People's Republic of China.

Notes: 1 = worst possible situation; 7 = best situation.

Quality of Infrastructure is one of the indicators used to measure global competitiveness in an annual survey conducted by the World Economic Forum. The scores are based on opinions of business leaders in a survey conducted in 148 economies.

Source: World Economic Forum (2013).

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

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

Preferential liberalization is a relatively recent phenomena in South Asia–East Asia economic relations (Asher and Sen 2008; Scollay and Pelkmans-Balaoing 2009). A handful of South Asia–East Asia FTAs exist and most of them have only taken effect in the last decade (see Table 6). Furthermore, these FTAs have only involved South Asia's two largest economies, India and Pakistan. While it is early days in South Asia–East Asia FTAs, two concerns arise from the current pattern.

First, the agreements in effect vary considerably in their provisions relating to reducing barriers on trade in goods, trade in services, and new trade policy issues relating to regulatory barriers. Table 8 provides a summary of our assessment of liberalization in major South Asia–East Asia FTAs in the areas of goods, services, and regulatory barriers.<sup>9</sup> Our results suggest that South Asia–East Asia FTAs fall into two types: (i)

<sup>9</sup> This was based on the criteria detailed in Wignaraja, Ramizo, and Burmeister (2013). Goods liberalization is assessed on the speed and coverage of tariff liberalization based on the criteria for FTAs in the WTO General Agreement on Tariffs and Trade. Services liberalization is assessed on the number of services sectors covered based on the WTO General Agreement on Trade in Services. Coverage and liberalization in the areas of new trade issues such as intellectual property and the Singapore issues (investment, government procurement, trade facilitation, and competition) were based using criteria for individual issues such as adherence to international agreements such as the WTO



limited agreements that deal mainly with barriers to goods trade, and (ii) agreements that extend liberalization beyond goods trade to tackle services and regulatory barriers. The APTA, the PRC–Pakistan FTA, and the Pakistan–Malaysia FTA are mainly goods agreements. The remaining FTAs listed in Table 8 are somewhat more comprehensive. The ASEAN–India FTA initially covered goods liberalization but has recently expanded to cover services and investment. The India–Singapore FTA excludes agriculture and transit but has reasonable coverage of services and cooperation enhancement provisions. The India–Republic of Korea FTA also has reasonable coverage of services and moderate coverage of regulatory barriers while the India–Japan FTA covers some services and has wider coverage of regulatory barriers. In general, there seems room for improvement in the coverage of services and regulatory issues in South Asia–East Asia FTAs.

**Table 8: Scope and Depth of South Asia–East Asia Free Trade Agreements**

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

ASEAN = Association of Southeast Asian Nations, FTA = free trade agreement, PRC = People's Republic of China.

Source: Author's assessment based on the methodology outlined in Wignaraja, Ramizo, and Burmeister (2013).

Second, use of tariff preferences in South Asia–East Asia FTAs differs between agreements. Certificate-of-origin information drawn from customs authorities' or business associations' databases comprehensively cover all users of FTA preferences within a given economy. Unfortunately, one of the difficulties in investigating the evolution of South and East Asian FTA preferences is that the significant majority of these economies do not publish such official information. Fortunately, we were able to obtain some information on export value using FTA preferences from national sources in Thailand, Malaysia, and Viet Nam for a few FTAs (Thailand–India FTA, ASEAN–India FTA, and Pakistan–Malaysia FTA). The data are in Table 9. The Thai data show an increase in the combined utilization rate of the Thailand–India FTA and the ASEAN–India FTA from 17.6% to 36.6% between 2005 and 2011. The Viet Nam data also indicate an increase in utilization of the ASEAN–India FTA between 2010 and 2011, but its 2011 figure (7.4%) is lower than that of Thailand. However, the Malaysian data indicate a significant increase in utilization of the Pakistan–Malaysia FTA from 1.4% to 74.3% between 2006 and 2010.

**Table 9: Export Value Using South Asia–East Asia Free Trade Agreement Preference (%)**

	2005	2006	2007	2008	2009	2010	2011
<b>Thailand</b>							
India <sup>a</sup>	17.6	18.1	14	12.3	11	33.4	36.6
<b>Malaysia</b>							
India <sup>b</sup>						10.8	n.a.
Pakistan <sup>c</sup>		1.4	1.3	70.3	71.8	74.3	n.a.
<b>Viet Nam</b>							
India <sup>b</sup>						2.4	7.4

ASEAN = Association of Southeast Asian Nations, FTA = free trade agreement, n.a. = not available.

Notes:

<sup>a</sup> Thailand–India FTA and ASEAN–India FTA

<sup>b</sup> ASEAN–India FTA.

<sup>c</sup> Malaysia–Pakistan FTA.

Source: National sources.

Thus, the evolving trend toward South Asia–East Asia FTAs carries two risks: a tendency toward insufficient liberalization and depth of agreements as well as suboptimal preference use. Section 3 offered a case for a broad pan-Asian FTA covering ASEAN+3 and all South Asian countries. Asia should pursue a geographically broad scheme, instead of an expanding web of bilateral and subregional agreements. Against a backdrop of slow progress in the WTO Doha Round trade talks, a pan-Asian trade agreement can promote continuing liberalization, induce structural reforms in the countries concerned, and widen market access across the region. With a view to making the proliferation of FTAs between South and East Asia “stepping stones” rather than stumbling blocks to multilateralism and to reduce inefficiencies due to overlapping rules of origin and others, policy makers in the region may wish to adopt the concept of “open regionalism” and broaden FTAs by creating as large and as wide a market as possible.

In this vein, one major pan-Asian FTA under negotiation is noteworthy. In November 2012, ASEAN members and their FTA partners (including India, Japan, the PRC, the Republic of Korea, Australia, and New Zealand) agreed to negotiate an RCEP that would result in the world’s largest trading bloc covering 40% of world trade (Chia 2013). The first round of RCEP negotiations took place in middle of 2013 with the ambitious goal of finishing in 2015. India is the only South Asian economy to join the negotiations thus far. This will give Indian business a greater opportunity to access markets in East Asia and to integrate into regional production networks. None of the other South Asian economies has expressed a desire to join the RCEP, but this may change if they become concerned about being left out of the large regional integration group.

### 3.3 Trade Barriers and Cumbersome Business Procedures

While there is technically an increasingly complex web of bilateral and subregional agreements across Asia, levels of most favored nation protection and rules and regulations affecting business remain basic elements in the incentive regime facing business. In conjunction with infrastructure- and rules-based costs, the pattern of trade between South and East Asia reflects variations in incentives. Tariff protection has been falling in recent years in South Asia, but overall levels are typically higher than in East Asia and reductions can stimulate business. Table 10 shows import tariffs for

agriculture and manufactures for 1990, 2000, and 2012 along with information on nontariff measures (NTMs) implemented during the period 2008–2012. The average agricultural tariff in India, for example, is 28.9% (2012), while for the PRC (reflecting a decade of accession to the WTO) it is 13.6%. Interestingly, average manufacturing tariffs for the PRC and India are the same at 9.2% (2012), with India showing a large reduction between 2000 and 2012. Furthermore, while tariffs seem low in many East Asian countries, there is some room for reduction in protection, especially in NTMs. During the post-global financial crisis era of 2008–2012, the numbers of NTMs implemented were 107 for the PRC, 52 for Indonesia, and 23 for the Republic of Korea. These figures compare with 86 for India, 9 for Pakistan, and 3 for Sri Lanka.

**Table 10: Simple Average MFN Tariffs and Nontariff Measures Implemented**

	Simple Average MFN Tariffs Agricultural Materials (%)			Simple Average MFN Tariffs Manufactures (%)			NTMs Implemented
	1990	2000	2012	1990	2000	2012	2008–2012
India	77.0	29.5	28.9	84.1	34.2	9.2	86
Pakistan	45.5	19.1	14.6	n.a.	20.9	14.3	9
Bangladesh	99.5	22.0	17.2	123.1	22.1	14.5	0
Sri Lanka	38.1	16.6	19.1	27.0	8.0	7.4	3
Maldives	18.2	18.2	17.9	n.a.	20.4	20.7	n.a.
Nepal	9.4	11.6	11.3	18.9	13.8	12.2	0
Afghanistan	n.a.	2.9	6.3	n.a.	4.3	5.9	1
Bhutan	14.3	17.1	37.2	15.5	n.a.	18.3	0
<i>Memo Items</i>							
PRC	42.5	23.5	13.6	43.9	16.5	9.2	107
Indonesia	20.1	7.2	5.0	19.3	9.0	7.3	52
Korea, Rep. of	11.4	11.1	26.3	7.8	8.1	7.4	23
Malaysia	12.7	4.4	10.1	9.4	8.1	6.1	4
Thailand	40.5	34.4	18.6	41.7	16.1	8.7	8
Philippines	23.1	8.2	6.8	20.9	7.0	5.1	5
Viet Nam	17.7	22.6	15.4	14.3	16.3	9.1	14

MFN = most favored nation, NTM = nontariff measure, PRC = People's Republic of China.

Notes: Where data are not available the most recent year is used.

NTMs are policy measures, other than customs tariffs, that can potentially have an effect on trade costs by changing prices, quantity traded, or a combination of both. The above data cover 23 types of NTM.

Source: World Bank World Integrated Trade Solutions (<http://wits.worldbank.org/wits/>) and World Development Indicators (<http://data.worldbank.org/indicator>) for simple average MFN tariffs; Global Trade Alert Database (<http://www.globaltradealert.org/site-statistics>) for nontariff measures.

Similar comments typically apply to business procedures. East Asia is typically a more open destination than South Asia in terms of procedures affecting business start-up and trading, as well as investor protection. Table 11 provides data on different aspects of business procedures—protecting investors, starting a business, and trading across borders—as well as a ranking of the overall ease of doing business globally. As the earliest adopter of economic reforms in South Asia, Sri Lanka has the highest rank (85th) within the subregion. Maldives (95th) comes next. However, the large South Asian economies (Bangladesh, India, and Pakistan) achieve rankings well in excess of 100. Meanwhile, Malaysia is ranked 6th, the Republic of Korea 7th, and Thailand 18th. Hence, East Asia serves as a more preferred destination for FDI than South Asia. East Asia also benefits more from the potential for regional integration of industries through

a dense network of global production networks and supply chains, as well as large domestic markets.

Efforts at trade liberalization and streamlining business procedures in South Asia need to be embedded in a wider program of so-called second generation economic reforms to support inclusive growth.<sup>10</sup> Important measures would include fiscal consolidation, reform of state-owned enterprises, improvement of domestic competition policy, reforms to the civil service and delivery of public goods, and reforms to institutions that create human capital (such as health and education). In parallel to trade liberalization, South Asian economies should also take steps to boost the international competitiveness of the industries in which they have comparative advantages. This would require efforts to attract FDI, promote the development of small and medium-sized enterprises, improve metrology standards and quality management, and increase spending on research and development.

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<sup>10</sup> For recent assessments of reform efforts and the case for second generation reforms to boost inclusive growth in South Asian economies, see Dee (2012) and Wignaraja (2012).

Table 11: Doing Business Indicators, 2014

Economies	Ease of Doing Business Rank	Protecting Investors	Starting a Business		Trading across Borders					
		Strength of investor protection index (0–10)	Procedures (number)	Time (days)	Documents to export (number)	Time to export (days)	Cost to export (\$ per container)	Documents to import (number)	Time to import (days)	Cost to import (\$ per container)
India	134	6.3	12	27	9	16	1,170	11	20	1,250
Pakistan	110	6.3	10	21	8	21	660	8	18	725
Bangladesh	130	6.7	7	10.5	6	25	1,075	8	35	1,430
Sri Lanka	85	6.0	6	8	5	20	595	7	17	775
Maldives	95	5.3	5	9	7	21	1,625	9	22	1,610
Nepal	105	5.3	7	17	11	42	2,295	11	39	2,400
Afghanistan	164	1.0	3	5	10	81	4,645	10	85	5,180
Bhutan	141	3.7	8	32	9	38	2,230	12	38	2,330
<i>Memo Items</i>										
PRC	96	5.0	13	33	8	21	620	5	24	615
Korea, Rep. of	7	6.0	5	5.5	3	8	670	3	7	695
Indonesia	120	6.0	10	48	4	17	615	8	23	660
Thailand	18	7.7	4	27.5	5	14	595	5	13	760
Malaysia	6	8.7	3	6	4	11	450	4	8	485
Philippines	108	4.3	15	35	6	15	585	7	14	660
Viet Nam	99	3.3	10	34	5	21	610	8	21	600

## Notes:

1. The Protecting Investors indicator assesses the strength of minority shareholders' protection against directors' misuse of corporate assets for personal gains. A score of 10 means highest standards of protection are given to investors.
2. The Starting a Business indicator covers preregistration, registration, and post registration.
3. The Trading across Borders indicator assesses the time and cost (excluding tariffs) of exporting and importing a standard containerized cargo by sea transport and the number of documents needed to complete the transaction.

Source: World Bank. 2013. *Doing Business Report 2014*. Washington, DC.

### 3.4 Barriers to Service Trade

Public discussions and research on South Asia–East Asia integration has focused on manufacturing trade and neglected trade in services. Part of the explanation lies in the large assortment of activities contained within the services sector, which are difficult to document or analyze. Studies suggest that services have been on the rise in output in Asia. From 45% of the average share in 1990, the services sector made up 48.5% of GDP in 2010 (Noland, Park, and Estrada 2013). In newly industrializing economies of East Asia such as the Republic of Korea; Hong Kong, China; and Taipei, China, the services sector has GDP shares of 60%–90%. In ASEAN economies (with the exception of Singapore and the Philippines), the sector makes up less than 50% of GDP. South Asian economies have uniformly rapidly growing services sectors particularly India, Sri Lanka, and Nepal where shares have risen by 15–20 percentage points, respectively.

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

Overall estimates of the magnitude of trade in services between South and East Asia are not available, but there seems to be growth in selected sectors in selected countries (Findlay, Ochiai, and Dee 2009). Export of IT services from India to East Asia and South Asia represented 4.0% and 0.2% of total IT services exports in 2011–2012, respectively (RBI 2013). India's IT services exports have been growing at an annual average rate of 14.5% and there is considerable potential for further expansion. Top Indian IT firms are currently attempting to diversify their markets using various strategies, such as setting up offices in the PRC to serve the local market and to attract Japanese outsourcing business by employing workers from the PRC and Japan to overcome the language barriers.

Contractual construction and labor services are the PRC's major service sectors, especially in Asia (Findlay, Ochiai, and Dee 2009). In Asia, approximately 69% of construction exports (through 2004) have been to East Asia, with the remaining 31% destined for South Asia. In South Asia, Pakistan is one of the most important markets for contractual construction service exports from the PRC. The PRC also has some history of construction and labor exports to Sri Lanka and Bangladesh. Meanwhile, South Asian and ASEAN countries export labor services, and remittances from these economies are also increasing. Japan and the Republic of Korea are likely to provide new opportunities for the movement of labor as their respective workforces age.

However, there is evidence of important impediments to trade and investment inhibiting trade in services between the regions. Table 12 provides a services trade restrictiveness index from the World Bank for 2012. This attempts to capture the policies and regulations that discriminate against foreign services or foreign service providers as well as certain key aspects of the overall regulatory environment that have a notable impact on trade in services. A high score suggests greater restrictiveness. Measuring services trade restrictiveness is a difficult undertaking beset by data gaps

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<sup>11</sup> Trade in services is the sum of services exports and imports divided by the value of GDP. Estimated from the World Bank's World Development Indicators database.

and subjective judgments. Bearing this qualification mind, the data suggest that India has greater restrictions on trade in services than large East Asian economies such as the PRC, Japan, and the Republic of Korea. Trade in services restrictions in Bangladesh, Nepal, and Sri Lanka are slightly lower (or comparable) with levels in the Philippines, Indonesia, Thailand, and Malaysia.

**Table 12: Services Trade Restrictiveness Index, 2012**

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

Note: The World Bank's Services Trade Restrictions Database collects and makes publicly available information on services trade policy assembled in a comparable manner across 103 countries, 5 sectors (telecommunications, finance, transportation, retail and professional services), and the key modes of service supply. A high score suggests greater restrictiveness.

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

Enhancing services trade between South and East Asia will be a long and challenging process. It will involve creating competitive services markets through a combination of policy reforms, productivity improvements, and investments in infrastructure and human capital (Noland, Park, and Estrada 2013).

## **4. QUANTIFYING THE BENEFITS OF PAN-ASIAN INTEGRATION**

Multi-country computable general equilibrium (CGE) models can quantitatively assess the benefits and costs of regional integration schemes, including those involving South Asian and East Asian economies. The aim of a CGE modeling approach is to incorporate the complex relations between prices, markets, and income. A multi-country model permits taking account of the effects of a changing world economic environment and feedback linked to bilateral trade liberalization. As a CGE modeling

approach has advantages and limitations, its results should be interpreted with caution.<sup>12</sup>

A few studies have analyzed the impact of policy scenarios involving South Asian FTAs as well as India–East Asia FTAs.<sup>13</sup> The policy scenarios in early CGE studies narrowed the focus on FTAs involving only goods, while more recent studies have broadened the FTA coverage to other aspects of trade such as services and trade costs. To the best of our knowledge, however, there is an absence of work on policy scenarios involving a South Asia–East Asia FTA. Accordingly, the results of a comprehensive CGE exercise by Francois and Wignaraja (2009) on various FTA scenarios involving South Asian and East Asian economies are reported here.<sup>14</sup>

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

1. An ASEAN–India FTA: free trade among the 10 ASEAN members and India. This scenario shows the impact of India’s Look East Policy with ASEAN. A trade in goods agreement is in effect between India and ASEAN, while agreements on services and investment have been concluded.
2. An ASEAN+3–India FTA: free trade among the 10 ASEAN members, the PRC, Japan, the Republic of Korea, and India. This scenario provides an extension of India’s Look East Policy to the whole of East Asia. This includes all the major Asian players in the RCEP negotiations. However, Australia and New Zealand are not included.
3. An ASEAN+3–South Asia FTA: free trade among the 10 ASEAN members, the PRC, Japan, the Republic of Korea, and all South Asian countries. This scenario provides an extension of India’s Look East Policy to the whole of East Asia. This includes all the major Asian players in the RCEP negotiations. However, Australia and New Zealand are not included.
4. An EU–India FTA: free trade among the EU members and India. This scenario shows the impact of a comprehensive EU–India FTA covering goods, services, and trade cost reduction. FTA negotiations between India and the EU have been ongoing since 2007.
5. A US–India FTA: free trade between the US and India. This scenario represents an FTA that is not even under official study by either India or the US.

<sup>12</sup> A CGE modeling approach is useful in quantifying income effects of eliminating import tariffs on goods trade and liberalizing cross-border trade in services through the formation of regional integration schemes (such as FTAs). It can trace economy-wide effects of policy changes and point to unintended economic consequences. However, a major limitation of a CGE modeling approach is its inability to incorporate rules of origin, nontariff measures (e.g., technical barriers to trade and public procurement regimes), and new trade issues (e.g., intellectual property and competition policy) which may afford more protection for domestic industries than tariffs. Another is that the underlying national input–output tables may be somewhat dated. Accordingly, a CGE approach is best deployed when combined with analysis of the complex structure of FTAs and business perceptions of the benefits of FTAs.

<sup>13</sup> For CGE studies of South Asian FTAs, including the South Asia Free Trade Agreement, see Siriwardana (2003), Bandara and Yu (2003), and ADB and UNCTAD (2008). Meanwhile, Mohanty and Pohit (2008), Cheong and Tongzon (2013), and Kawai and Wignaraja (2013) examine FTA scenarios involving India, East Asian economies, Australia, and New Zealand.

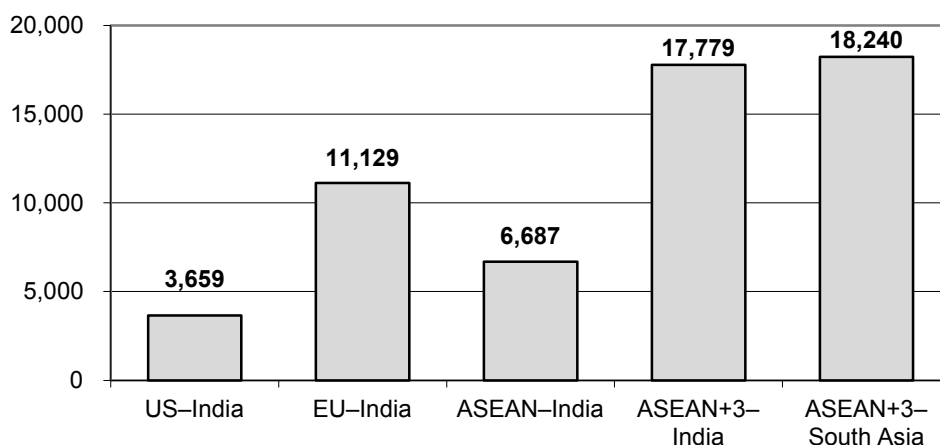
<sup>14</sup> Four features of the CGE model used in Francois and Wignaraja (2009) are noteworthy: (i) strong microeconomic foundations and detailed interactions among industries, consumers, and governments across the global economy; (ii) medium- to long-run investment effects by allowing for trade to affect capital stocks through investment activities; (iii) use of the Global Trade Analysis Project database through to 2017, which projects trade and production patterns to represent a post-Uruguay Round world; and (iv) a stylized FTA that includes goods, services, and trade cost reduction.



The scenarios chosen illustrate several important FTA possibilities for South Asia. The subsequent discussion will focus on economic effects of these scenarios for India and its neighbors.

Figure 1 shows the estimated impacts on India's national income of the FTA scenarios 1–5. The model's baseline is 2017 and the simulations show changes from this baseline. Interestingly, India gains more in terms of economic welfare from pursuing large integration schemes with Asian economies than those with either the EU or the US. In this vein, India reaps significant welfare gains from scenarios 2 and 3 by involving dynamic East Asian economies (ASEAN, the PRC, Japan, and the Republic of Korea) in FTA arrangements. Nonetheless, an ASEAN+3–South Asia FTA scenario offers larger gains to India than the ASEAN+3–India FTA scenario.<sup>15</sup> This suggests that India gains more by including the rest of South Asia in a trading arrangement with East Asia than going it alone with East Asia. Among the other three scenarios shown in Figure 1, the EU–India FTA scenario offers the next largest gains for India, followed by an ASEAN–India FTA and a US–India FTA.

**Figure 1: Welfare Impacts on India of Different Free Trade Agreement Scenarios**  
(\$ million change compared to 2017 baseline, at constant 2001 dollars)



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

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

Noting that an FTA with East Asia offers larger welfare gains for India than those with the EU or the US, Table 13 shows the detailed results for scenarios 1–3. The broadest scenario 3, which includes ASEAN+3 countries and all the South Asian countries, sees income gains for members of the FTA of about 2.0% of base income for South Asia and 2.4% for ASEAN+3 countries. In terms of changes in base income, there are substantial income gains for India and other South Asian countries. Pakistan, however, experiences smaller income gains (0.2%). These results relate to a mix of improved market access, opening up of markets, and improvements in logistics and trade costs. There are minimal negative effects for outsiders to the broad ASEAN+3–South Asia FTA. The EU sees a small gain while the US and the rest of the world see small losses.

<sup>15</sup> The ASEAN+3–South Asia FTA scenario, an illustrative example of a broad region-wide scenario, offers larger gains to India's income (\$18.2 billion, measured in constant 2001 prices) than the ASEAN+3–India FTA scenario (\$17.8 billion). These are conservative estimates of the minimum gains that would arise from such an integration scenario.

**Table 13: National Income Effects of Alternative Free Trade Agreement Scenarios**  
(value and % change compared to 2017 baseline, at constant 2001 dollars)

	ASEAN–India FTA		ASEAN+3–India FTA		ASEAN+3–South Asia FTA	
	Value (\$ million)	% change	Value (\$ million)	% change	Value (\$ million)	% change
<b>South Asia</b>	<b>6,466</b>	<b>0.57</b>	<b>16,199</b>	<b>1.44</b>	<b>22,423</b>	<b>1.99</b>
India	6,630	0.83	17,779	2.23	18,240	2.29
Pakistan	-46	-0.03	-862	-0.58	298	0.20
Bangladesh	-31	-0.03	-355	-0.31	1,874	1.66
Sri Lanka	-11	-0.04	-123	-0.40	631	2.03
Other South Asia	-75	-0.20	-240	-0.65	1,380	3.73
<b>ASEAN+3</b>	<b>5,264</b>	<b>0.05</b>	<b>240,810</b>	<b>2.38</b>	<b>243,296</b>	<b>2.40</b>
PRC	-882	-0.03	43,289	1.32	43,454	1.32
Japan	-664	-0.01	78,080	1.61	78,650	1.62
Korea, Rep. of	-396	-0.05	51,545	6.46	52,100	6.53
Cambodia	1	0.01	106	1.18	79	0.88
Indonesia	1,384	0.46	8,818	2.93	9,090	3.02
Malaysia	1,925	1.03	12,014	6.40	12,376	6.60
Philippines	392	0.33	3,521	2.93	3,495	2.91
Singapore	1,644	0.99	9,285	5.60	9,717	5.86
Thailand	1,879	0.85	28,220	12.78	28,534	12.92
Viet Nam	194	0.27	5,449	7.57	5,428	7.54
Other Southeast Asia	-214	-0.19	483	0.43	374	0.33
European Union	1,130	0.01	9,248	0.08	10,300	0.09
United States	1,036	0.01	-3,214	-0.02	-1,924	-0.01
Rest of the World	1,008	0.01	-11,681	-0.13	-13,188	-0.14
<b>World</b>	<b>14,904</b>	<b>0.03</b>	<b>251,363</b>	<b>0.52</b>	<b>260,907</b>	<b>0.54</b>

ASEAN = Association of Southeast Asian Nations, ASEAN+3 = ASEAN, plus the PRC, Japan, and the Republic of Korea, FTA = free trade agreement, PRC = People's Republic of China.

Note: Other South Asia refers to Afghanistan, Bhutan, the Maldives, and Nepal. Other Southeast Asia refers to Brunei Darussalam, the Lao People's Democratic Republic, and Myanmar.

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

Comparing scenarios 1 (an ASEAN–India FTA)<sup>16</sup> and 2 (an ASEAN+3–India FTA), a consistent pattern is visible of notable gains for regional participants and minimal effects for outsiders. India's gains increase significantly from 0.83% of base income to 2.23% between the two scenarios due to inclusion of the large Northeast Asian neighbors into an FTA arrangement. The other South Asian countries lose by not being included in either arrangement.

The outcome of scenario 3 implicitly assumes that South Asia is internally quite well integrated. However, studies argue that the South Asia Free Trade Agreement (SAFTA) process involving the eight South Asian Association for Regional Cooperation

<sup>16</sup> Francis (2011) analyzes tariff reduction commitments under the ASEAN–India FTA and the extent of potential market access that ASEAN countries will gain in India's agriculture and non-agriculture sectors. She points to potential gains and losses from import liberalization under the FTA. Heavy manufacturing branches (transport equipment, machinery, chemicals, and iron and steel) are likely to gain as the entry of MNCs will facilitate integration into Asian production networks. However, semi-processed and processed agricultural products, and light manufacturing are likely to be adversely affected by increased market access for cheaper ASEAN imports.

members has lost momentum and that South Asia remains one of the least integrated regions globally (Weerakoon 2010; Khan 2012). Fears of domestic industries in smaller South Asian economies being swamped by cheap Indian imports, restrictions on India–Pakistan trade, bureaucratic inertia, and security concerns explain the limited progress in South Asian integration.

Nonetheless, to illustrate potential benefits of South Asian integration, Francois and Wignaraja (2009) also report the outcome of an evolving SAFTA process (covering goods, services, and trade facilitation). This scenario seems useful as SAFTA has had a goods agreement in effect for some years and a services agreement took effect in 2012 as an expansion of SAFTA. The welfare gain from a South Asian FTA scenario (covering goods, services, and trade facilitation) amounts to about US\$3.7 billion (or 0.33% of South Asia's base income).<sup>17</sup> All South Asian economies see gains in base income but smaller economies experience particularly notable gains, which is encouraging for South Asian integration.

## 5. CONCLUSIONS

This paper examined the experience of South Asia–East Asia integration focusing on whether South Asian economies benefit from integrating with East Asia and whether there are economic grounds for India to include its South Asian neighbors in the process. To address these questions, the paper examined trade, FDI, and FTA patterns; impediments to South Asia–East Asia integration; and the results of a CGE assessment of policy scenarios for regional integration based on FTAs.

Three important points emerge from the research:

First, there is evidence of increased economic integration between South and East Asia but the process is uneven.<sup>18</sup> Bilateral trade flows have grown rapidly from a small base since 1990, led by India and, to a lesser extent, Pakistan. FDI flows particularly from East Asia to South Asia have increased but levels are smaller than regional trade flows reflecting higher costs and risks of setting up overseas plants rather than trading from home. Additionally, the bulk of East Asian FDI goes to India. Little regional policy integration has occurred with only a handful of recent South Asia–East Asia FTAs focusing on India and Pakistan. Smaller South Asian economies are in the early stages of integration with East Asia—imports from East Asia have grown, but exports, inward investment, and FTAs have lagged.

Second, a myriad of problems hamper the development of further economic integration between South and East Asia. Key impediments include gaps in cross-border infrastructure, a risk of insufficient depth and business use of FTAs, trade barriers and cumbersome business procedures, and barriers to services trade. Coherent remedies at the regional and national levels are required to tackle these issues, including investing more and improving the quality of cross-border infrastructure, developing a

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<sup>17</sup> The regional estimates of the economic effects of a South Asian FTA reported in Francois and Wignaraja (2009) resemble Siriwardana (2003) who reports gains for South Asia of about US\$4 billion. Other studies, which look mostly at goods trade liberalization, suggest gains of less than US\$1 billion from a South Asian FTA. Accordingly, Bandara and Yu (2003) suggest gains for South Asia of US\$771.4 million and ADB and UNCTAD (2008) of US\$858.3 million. Reflecting its economic size in South Asia, India sees gains of US\$3.1 billion in Siriwardana (2003), US\$756.2 million in Bandara and Yu (2003), and US\$366.0 million in ADB and UNCTAD (2008).

<sup>18</sup> With the benefit of a few additional years of data, our conclusion about the pace of South Asia–East Asia economic integration is somewhat more nuanced and qualified than earlier studies (e.g., Asher and Sen 2008).

broad FTA covering ASEAN+3 and South Asia that is comprehensive in scope, continuing the lowering of trade protection and implementing a wider program of domestic structural reforms, and reducing barriers to services trade and investing in human capital.

Third, a careful consideration of the results of a CGE quantitative exercise indicates regional integration policy choices for India and the rest of South Asia. In essence, India and other South Asian economies will benefit from a broad pan-Asian FTA arrangement that involves East Asia as well as the rest of South Asia. However, if India goes on it alone in an FTA with East Asia, the rest of South Asia will experience losses and India's gains will be smaller. Additionally, India will see larger gains from an FTA with East Asia than one with the EU or the US. Hence, the simulation results suggest that a comprehensive South Asia–East Asia FTA is an optimal policy choice for South Asia and that India has an incentive to include its neighbors in a trading arrangement with East Asia. One route would be for India to reinvigorate economic integration within South Asia by encouraging a comprehensive SAFTA (which significantly reduces trade barriers between India and Pakistan). India's South Asian neighbors should follow suit by deepening South Asian integration and actively fostering closer economic ties with East Asia.

It has been recognized that the process of “regionalism is too complex and sui generis to generate universal operational rules” (Schiff and Winters 2003: 25). Nonetheless, rules of thumb or lessons of experience can be drawn from international experience that might be relevant to the development of a coherent pan-Asian regional integration strategy in most circumstances. One lesson is that there is no one-size-fits-all strategy when it comes to South Asia–East Asia economic integration. Key ingredients of a regional strategy—such as investment in infrastructure, improvement of logistics, FTAs, and public–private partnerships—need to be modified and sequenced to suit individual country needs and priorities. Another lesson is to promote market orientation in the regional strategy. Emphasis on markets for resource allocation and promotion of greater competition on domestic markets encourages efficiency. Where market imperfections arise, however, intervention may be required.

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