

# 1. Introduction and overview

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## 1.1 MOTIVATION AND OBJECTIVES OF THE STUDY

The international marketplace has become increasingly important to sustainable growth and development in South Asian and Southeast Asian countries. These economies have been deepening their interaction with the global economy through unilateral reforms to enhance economic efficiency, as well as via regional approaches to deepening economic integration, for example, through bilateral and regional free trade agreements (FTAs). The result has been remarkable: through economic reform, Asia has succeeded in significantly reducing poverty, improving social indicators, developing new markets and market niches, and creating an increasingly powerful middle class. According to the ADB and the ADBI (2014), India will more than double its share of world gross domestic product (GDP) by 2030, the Association of Southeast Asian Nations (ASEAN) will increase its share by about 50 percent, and per capita income will treble in the former and increase by 2.5 times in the latter. Internationalization of the South Asian and Southeast Asian economies is an important engine in these growth forecasts. Supportive policies will be necessary to attain them.

Thus, economic integration has been an important determinant of past economic success and a key ingredient in the recipe for future growth in South Asia and Southeast Asia.<sup>1</sup> But have these two outward-oriented regions integrated well with each other? Have they been able to exploit dynamic synergies that might be tapped via closer economic integration? The evidence presented in this book suggests that integration of the two regions has progressed much less than its potential, and has been limited by numerous factors, including physical connectivity (transport and energy infrastructure) and its accompanying 'soft infrastructure' (tariffs, non-tariff measures, transport and trade restrictions, restrictions on financial institutions and capital flows, institutional shortcomings, among others).

This may have been less important in an era when the developed economies, mainly the United States and Europe, were the engines of world growth. However, the period following the global financial crisis of 2007–09 has seen a ‘new normal’ of sluggish growth in the major developed economies, especially in Europe, which some have characterized as ‘secular stagnation’ (Summers 2014). As a result, Asian economies need to rely more on domestic and regional growth. The emergence of the People’s Republic of China (PRC) as a new world growth engine has dramatically altered the global economic landscape, but even the PRC’s growth prospects look slower than was seen earlier. Therefore South Asian and South Asian economies have a strong incentive to consider policies that will maximize the gains from greater integration.

In particular, the successful development of global supply chain networks in East Asia and Southeast Asia should be of great interest to South Asia (Athukorala 2011). These networks have made it easier for lower-income countries to break into high value-added manufacturing sectors, such as electronics and automobiles, and have accelerated processes of foreign direct investment, trade and productivity growth, with numerous positive spillover effects. To date, South Asian economies have participated much less in such networks, and thus have largely forgone these growth opportunities (Tiwari et al. 2015).

The opening up of Myanmar in both political and economic terms (ADB 2014; WTO 2014) has also increased the potential benefits from greater integration of the two regions, as well as providing another connection to the PRC. Myanmar provides the only land bridge for road and rail connectivity between the two regions. Moreover, it has rich resources of minerals, energy and agriculture, and increased trade with South Asia in these areas could bring substantial benefits to both sides.

The goal of this book is to identify the main constraints to South Asian–Southeast Asian economic integration, to provide specific policies that governments – together with the private sector and other development partners – should follow to overcome them, and to estimate the potential benefits and costs of those policies. It surveys the key issues, delineates existing bottlenecks and what can be done to resolve them, and considers the stakes involved, that is, the benefits and costs of deepening inter-regional links. It offers policy recommendations for governments, presents promising new approaches for regional institutions, identifies priority projects, and uses a computable general equilibrium model to estimate overall benefits and impacts of various scenarios of greater cross-regional integration.

This book takes two approaches to the analysis of South Asian–Southeast Asian economic cooperation and integration. First, it looks at

cross-regional ‘functional’ issues, including cross-border transport infrastructure, sea transport, trade facilitation, finance, institution-related implementation challenges to integration, and also analyzes the aggregate economic ‘pay-off’ of inter-regional economic cooperation. These functional topics are not comprehensive but do reflect priorities articulated in the literature related to constraints on South Asian–Southeast Asian economic integration.

Second, the book focuses on individual countries in order to identify bottlenecks and opportunities at the national level. The country case studies include Bangladesh, India, Myanmar, Nepal, Sri Lanka and Thailand, as they are the countries closest to the intersection of the two regions, and where policy changes have the greatest potential to promote increased integration. The PRC was not included, but its role clearly has to be considered.

By taking functional and country-specific approaches, the book identifies policy recommendations to deepen cross-regional cooperation via regional and country-specific initiatives. In this way, it is able to provide an overview of relevant issues applicable to all via plurilateral cooperation, as well as laying the groundwork for enhanced integration at the national level. Both perspectives are necessary to increase mutually beneficial economic cooperation and integration.

The rest of the chapter is organized as follows. Section 1.2 provides the historical background of integration between the two regions, and section 1.3 describes the current state of trade and investment integration. A summary of chapters in the book is presented in section 1.4. Finally, section 1.5 synthesizes some of the main findings of the study and summarizes key policy recommendations.

## 1.2 HISTORICAL BACKGROUND

Trade between South Asia and Southeast Asia has a long and prominent history dating back millennia. However, between the end of the Second World War in 1945 and the 1990s, South Asian and Southeast Asian economies were relatively isolated from one another and there was little talk of inter-regional economic integration. The only trade agreement that covered the two regions at all was the Bangkok Agreement signed in 1975 that included Bangladesh, India, Sri Lanka, and the Lao People’s Democratic Republic (Lao PDR), as well as the Republic of Korea and the PRC. There was very little bilateral trade and investment among these countries. The relative isolation between the two regions before 1990 stems from a lack of political signals to foster South Asian–Southeast Asian

integration, significant barriers to regional trade and investment, poor regional connectivity and cultural and linguistic barriers.

After the Second World War, India and Pakistan adopted import-substituting industrialization strategies with stringent quantitative import restrictions, high import tariffs, state-owned industries and other forms of government intervention (Rana and Dowling 2009; Chandra and Kumar 2010). These measures hampered resource allocation according to comparative advantage, exports, and private sector activity. To varying degrees, smaller South Asian economies pursued similar inward-oriented development strategies. Meanwhile, after an initial import-substitution period, Southeast Asian economies shifted to outward-oriented developed strategies from the late 1960s onward. These strategies emphasized trade liberalization and economic reforms that provided incentives for exports and the private sector. Southeast Asian economies typically achieved faster economic growth, industrialization, and reduction in poverty than South Asian economies.

The adoption in 1991 of the 'Look East Policy' by India and greater focus on outward orientation marked the start of a new era in South Asian and Southeast Asian economic relations (Box 1.1 contains highlights of South Asian–Southeast Asian economic relations). India's Look East Policy signaled its intent to revitalize its cultural, defense and economic ties with globally important East Asia (Asher and Sen 2008). Since then, there has been heightened policy interest in the process of inter-regional integration. Six FTAs have come into effect between South Asian and Southeast Asian economies. These include the landmark ASEAN–India Comprehensive Economic Cooperation Agreement in 2010 that covers trade in goods, services and investment. India also has bilateral FTAs with Singapore, Thailand and Malaysia. One concern is that India's FTAs with Southeast Asian economies lack sufficient depth in the sense that the World Trade Organization (WTO)-plus issues (such as competition, government procurement and intellectual property) were not included in such agreements. Following Indian Prime Minister Narendra Modi's visit to Japan in mid-August 2014, there was talk of a new Indian Look East Policy 3.0. The policy details were not known at the time of writing but such an initiative is likely to herald a renewed trade, investment and development cooperation relationship with Japan as well as with other East Asian economies.

While India has a formal Look East Policy, other South Asian economies have been more cautious in their strategic intent for closer economic integration with Southeast Asia. For instance, Pakistan has FTAs with two Southeast Asian economies. A Pakistan–Indonesia FTA was first concluded by opening market access of trade in goods. Subsequent

### BOX 1.1 SOUTH ASIAN–SOUTHEAST ASIAN ECONOMIC RELATIONS: HIGHLIGHTS

- 1975 Signing of the Bangkok Agreement by Bangladesh, India, Lao People's Democratic Republic (Lao PDR), Republic of Korea, Sri Lanka and People's Republic of China (PRC).
- 1985 Formation of the South Asian Association for Regional Cooperation (SAARC) by Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. Afghanistan joined in 2007.
- 1991 India adopted the Look East Policy to strengthen economic relationships with East Asian countries.
- 1992 Signing of the Association of Southeast Asian Nations (ASEAN) Free Trade Area (AFTA) by Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand. Other Southeast Asian countries joined later: Viet Nam (1995), Lao PDR and Myanmar (1997), and Cambodia (1999). The AFTA became fully operational in 2003.
- 1992 India became a sectoral dialogue partner of the ASEAN.
- 1993 Signing of the Agreement on the SAARC Preferential Trading Arrangement (SAPTA) by eight SAARC members. The SAPTA entered into force in 1997.
- 1995 India became a full dialogue partner of the ASEAN.
- 1997 East Asian financial crisis, which highlighted the importance of regional cooperation among East Asian economies.
- 2002 India–ASEAN partnership was upgraded to summit-level dialogue.
- 2003 Signing of the Framework Agreement on Comprehensive Economic Cooperation between India and the ASEAN, which laid out the basis for an ASEAN–India FTA.
- 2004 Signing of an Agreement on the South Asian Free Trade Area (SAFTA) during the twelfth SAARC Summit in Islamabad. The SAFTA came into force in 2006.
- 2004 Signing of a Long-term Partnership for Peace, Progress and Shared Prosperity by India and the ASEAN at the Lao PDR Summit.
- 2004 Signing of Early Harvest Scheme for the India–Thailand Free Trade Framework Agreement under which preferential concessions have been exchanged on a specified set of commodities.
- 2004 Signing of a Framework Agreement under the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) by Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.
- 2005 Signing of a Comprehensive Economic Cooperation Agreement (CECA) between India and Singapore.
- 2005 Renaming of the Bangkok Agreement as the Asia-Pacific Trade Agreement (APTA), which would offer up to 4000 tariff concessions among members.
- 2005 Signing of a Comprehensive Economic Framework Agreement between Pakistan and Indonesia.
- 2005 First meeting of the East Asia Summit in Kuala Lumpur, Malaysia.
- 2005 Discussions for the Comprehensive Economic Partnership Agreement (CEPA) started. Members of the CEPA are Australia, New Zealand, Japan, India, the PRC, the Republic of Korea and ASEAN.

- 2007 Signing of Pakistan–Malaysia Free Trade Agreement – Pakistan's first comprehensive FTA and Malaysia's first bilateral FTA with a South Asian country.
- 2009 The ASEAN–Pakistan Free Trade Agreement was proposed and consultations ensued.
- 2010 The ASEAN–India Comprehensive Economic Cooperation Agreement (ASEAN–India CECA) was signed and took effect.
- 2013 Negotiation for a Regional Comprehensive Economic Partnership (RCEP) was launched.
- 2013 The SAARC delegation went to the ASEAN Secretariat in Jakarta to discuss strengthened relations between the two regions. The discussions included creation of the ASEAN–SAARC Secretariat Partnership Work Plan (2008–2009) and intensified economic and security cooperation.

Sources: Francois et al. (2009); ADB Asia Regional Integration Center, <http://aric.adb.org/> (accessed 14 December 2014).

negotiations resulted in a Pakistan–Indonesia preferential trade agreement that came into force in January 2013, eliminating tariffs on goods and expanding the market further (Swire 2012). The Pakistan–Malaysia FTA is more comprehensive and includes liberalization of services and investment. However, neither agreement includes WTO-plus issues.

### 1.3 CURRENT STATUS OF CROSS-REGIONAL INTEGRATION

This new awareness of the great potential of inter-regional trade and investment has already led to impressive responses in terms of rising economic interchange. Inter-regional exports and imports have risen significantly since the early 1990s, with bilateral trade flows growing even faster than the overall trade of these two dynamic regions, and foreign direct investment (FDI) more than doubling over the past decade. However, these changes have proceeded from a very small base; inter-regional economic integration is still low and far below that expected given regional characteristics (Francois et al. 2009; Dasgupta et al. 2012; Wignaraja 2014a). While overall trade and investment liberalization in both regions has been remarkable over the past generation, inter-regional barriers have only fallen proportionately, even though, for example, intra-regional trade in ASEAN is now essentially tariff-free and the region has been embracing deep integration in the form of a stylized unified market, the ASEAN Economic Community (AEC). (See Plummer and Chia, 2009, for a detailed discussion of the AEC.) Difficulties related to trade and investment facilitation

are ubiquitous, infrastructure links remain problematic and inter-regional economic cooperation initiatives cover only parts of South Asia. In short, while economic integration is rising, it has a long way to go before it can reach its potential.

As Table 1.1 shows, the dollar value of South Asia's trade (total exports and imports) with Southeast Asia increased significantly between 1990 and 2013 from \$5.4 billion to \$84.7 billion. A similar trend is visible in Southeast Asia's trade with South Asia, which rose from \$4.2 billion to \$90.4 billion between 1990 and 2013. Not surprisingly, the larger economies in each region are the major drivers of cross-regional trade. In 2013, India accounted for as much as 78.6 percent of South Asia's trade with Southeast Asia while Bangladesh, Pakistan and Sri Lanka made up, respectively, 8.2 percent, 7.2 percent and 4.6 percent. Meanwhile, Singapore accounted for 26.7 percent of Southeast Asia's trade with South Asia, Indonesia for 24.9 percent, Malaysia for 19.5 percent and Thailand for 12.4 percent. Interestingly, over 1990–2013, Southeast Asia's share of South Asian trade rose slightly from 10 percent to 13 percent, whereas South Asia's share of Southeast Asia trade remained low despite the fact that it doubled from 2 percent to 4 percent.

The same story applies to cross-regional investment. Data on regional FDI flows are more limited than trade statistics. Since 2003, greenfield FDI from South Asia – particularly India – to Southeast Asia has been greater than Southeast Asian FDI to South Asia but in both cases the aggregate flows are small. Cumulative greenfield FDI inflows during 2003–13 from South Asia to Southeast Asia amounted to \$31.8 billion whereas the figure from Southeast Asia to South Asia was \$27.8 billion (Table 1.2). The main Southeast Asian recipients of South Asian FDI during 2003–13 were: Indonesia (44.9 percent), Viet Nam (17.6 percent) and Singapore (14 percent). Meanwhile, India (71 percent), Pakistan (15 percent) and Sri Lanka (6 percent) were the main South Asian recipients of Southeast Asian FDI. As Table 1.2 shows, Southeast Asia only accounted for 14 percent of total South Asian FDI outflows during 2003–13, and South Asia only received 8 percent of Southeast Asian FDI. Much more can be done to increase economic interchange.

Little cross-regional portfolio investment has occurred either. The International Monetary Fund's Coordinated Portfolio Investment Survey (<http://cpis.imf.org>, accessed 16 December 2014) shows that Southeast Asia invested \$44 billion in South Asia in 2012, about 5.1 percent of total outward portfolio investment from the region, but almost all of this came from Singapore, presumably most of which was funds originating from firms outside the region with regional offices in Singapore (Table 1.3). Excluding Singapore, outstanding portfolio investment from Southeast

Table 1.1 Merchandise trade between South Asia and Southeast Asia, 1990, 2000 and 2013

Country/region	Trade with South Asia (\$ million)			Trade with Southeast Asia (\$ million)			South Asia share of total trade* (%)			Southeast Asia share of total trade* (%)		
	1990	2000	2013	1990	2000	2013	1990	2000	2013	1990	2000	2013
Afghanistan	73.9	216.9	3044.8	82.3	21.5	384.7	13.3	28.5	40.6	14.8	2.8	5.1
Bangladesh	493.4	1064.4	7442.1	610.5	1592.8	6958.6	10.5	8.0	12.0	13.0	12.0	11.2
Bhutan	3.8	22.8	302.3	0.1	3.3	36.7	22.4	42.0	72.3	0.4	6.1	8.8
India	640.9	2454.7	10930.0	3055.4	9772.2	66601.4	1.9	2.8	2.3	9.1	11.3	14.1
Maldives	20.1	104.6	209.1	124.6	195.4	477.3	8.8	20.2	16.9	54.5	37.7	38.6
Nepal	69.2	405.2	3559.6	88.1	158.7	249.1	10.9	27.6	53.7	13.8	10.8	3.8
Pakistan	281.5	496.5	4119.3	960.1	1466.8	6112.0	2.5	3.2	7.7	8.5	9.5	11.4
Sri Lanka	284.1	829.1	5761.8	505.1	1205.5	3885.0	6.9	7.7	22.9	12.3	11.3	15.5
<i>Total South Asia</i>	1867.0	5594.1	35368.9	5426.1	14416.1	84705.0	3.4	4.3	5.6	9.8	11.2	13.4
Brunei Darussalam	2.1	6.3	807.1	1078.5	1585.9	5527.2	0.1	0.1	4.6	26.9	31.7	31.8
Cambodia	1.7	13.9	204.8	41.8	1177.0	9835.7	2.2	0.4	0.8	51.9	35.4	40.8
Indonesia	436.5	2202.1	22557.3	1286.2	8195.6	106829.4	1.0	2.3	5.8	3.0	8.5	27.5
Lao PDR	0.6	4.6	174.4	110.6	667.6	6262.1	0.3	0.5	1.7	60.4	69.4	60.4
Malaysia	1128.8	2815.3	17662.9	17929.3	60591.7	154785.3	2.0	1.4	3.5	31.2	30.9	31.0
Myanmar	105.9	301.3	2152.1	536.4	1717.4	12192.8	7.2	6.4	7.3	36.5	36.6	41.6
Philippines	76.0	313.7	2041.4	2132.1	14085.9	31240.3	0.4	0.4	1.3	10.4	16.0	19.2
Singapore	1668.6	4025.7	24165.8	19138.9	58447.8	135582.9	1.9	1.9	4.7	22.1	27.7	26.5
Thailand	669.5	1706.6	11214.1	7753.7	24109.4	82957.9	1.3	1.4	2.9	15.5	19.3	21.2
Viet Nam	97.3	280.4	9450.1	366.2	6041.3	42872.4	4.2	1.0	3.3	15.7	21.9	15.0
<i>Total Southeast Asia</i>	4187.0	11670.0	90429.9	50373.7	176619.5	588085.8	1.6	1.5	3.9	19.0	23.3	25.4

Notes:

\* Calculated as percentage of total trade going to South Asia or Southeast Asia as a share of total country or regional trade. Figures based on SITCI, as reported by South Asia and Southeast Asia.

Lao PDR = Lao People's Democratic Republic.

Sources: François et al. (2009); ADB Asia Regional Integration Center, <http://aric.adb.org/> (accessed 10 December 2014).

Table 1.2 Foreign direct investment flows between South Asia and Southeast Asia, 2003–13

Country/region	Inflows from Southeast Asia to South Asia		Share of total inflow (%)	Outflows from South Asia to Southeast Asia		Share of total outflow (%)
	Cumulative 2003–13	Share (%)		Cumulative 2003–13	Share (%)	
	<i>South Asia</i>	27 829	100.0	5.49	31 763	100.0
India	19 765	71.0	4.64	31 597	99.5	14.5
Pakistan	4 169	15.0	9.34	0.89	0.0	0.0
Sri Lanka	1 657	6.0	12.88	69.79	0.2	2.6
Maldives	1 452	5.2	27.83	NA	NA	NA
Bangladesh	729	2.6	6.68	93.7	0.3	14.6
Nepal	56.6	0.2	2.38	1.7	0.0	0.5
Afghanistan	NA	NA	NA	NA	NA	NA
	Inflows from South Asia to Southeast Asia		Share of total inflow (%)	Outflows from Southeast Asia to South Asia		Share of total outflow (%)
	Cumulative 2003–13	Share (%)		Cumulative 2003–13	Share (%)	
<i>South East Asia</i>	31 763	100.0	3.6	27 829	100.0	8.2
Singapore	4 433	14.0	3.2	13 042	46.9	10.0
Malaysia	2 122	6.7	2.0	11 606	41.7	9.3
Thailand	2 182	6.9	2.4	2 864	10.3	7.2
Indonesia	14 253	44.9	7.8	180	0.6	0.9

Table 1.2 (continued)

	Inflows from South, Asia to Southeast Asia		Share of total inflow (%)	Outflows from Southeast Asia to South Asia		Share of total outflow (%)
	Cumulative 2003–13	Share (%)		Cumulative 2003–13	Share (%)	
<i>South East Asia</i>						
Philippines	2006	6.3	2.8	126	0.5	1.3
Brunei Darussalam	NA	0.0	NA	10	0.0	5.4
Viet Nam	5587	17.6	2.3	NA	NA	NA
Myanmar	496	1.6	2.4	NA	NA	NA
Lao PDR	432	1.4	5.1	NA	NA	NA
Cambodia	253	0.8	1.5	NA	NA	NA

*Notes:*

The above figures cover only greenfield investments. FDI Markets define 'greenfield investments' as cross-border investments in a new physical project or expansion of an existing investment that creates new jobs and capital investment. Joint ventures are only included where they lead to a new physical operation. Mergers and acquisitions (M&A) and other equity investments are not included. Lao PDR = Lao People's Democratic Republic; NA = not available.

*Source:* fDi Markets, <http://www.fDimarkets.com> (accessed December 2014).

*Table 1.3 Regional portfolio investment holdings, as % share of total overseas investments*

% of total economies	South Asia			Southeast Asia		
	2005	2010	2012	2005	2010	2012
<i>Southeast Asia</i>	1.1	4.6	5.1	9.0	9.3	10.5
Indonesia	2.5	0.3	0.5	19.0	12.0	3.3
Malaysia	0.6	0.8	0.6	22.8	31.4	36.0
Philippines	0.3	0.0	NA	15.8	4.4	18.7
Singapore	1.1	5.1	5.6	8.6	8.1	8.9
Thailand	0.0	2.0	1.9	20.8	4.4	4.4
<i>South Asia</i>	2.5	2.2	0.2	4.4	6.2	6.5
India	6.2	1.0	0.1	8.7	6.5	8.3
Pakistan	0.0	12.4	0.5	NA	3.9	1.6

*Note:* NA = not available.

*Source:* IMF Coordinated Portfolio Investment Survey, <http://data.imf.org/> (accessed 16 December 2014).

Asia to South Asia in 2012 was small, at about \$896 million. Outstanding portfolio investment from South Asia to Southeast Asia in 2012 totaled only \$90 million – a fraction of total investment into Southeast Asia – although representing about 6.5 percent of South Asian outward investment (Table 1.3). There are also limits to cross-border bank loans and bank entry in to foreign markets in many cases, as well as onerous restrictions on foreign exchange transactions. Development of regional-level financial supervision and regulation could contribute to supporting greater volumes of international capital flows (Kawai and Morgan 2014).

Trade barriers of various kinds (including tariffs, non-tariff measures, and services trade restrictions) continue to constrain the scope for trade and investment between South Asia and Southeast Asia. Tariffs for agriculture and manufactured goods have typically fallen to historically low levels in South Asia and Southeast Asia. As Table 1.4 shows, simple average most favored nation (MFN) tariff rates for agriculture in South Asia fell from 43.2 percent to 19.2 percent between 1990 and 2013, while those for manufactures fell from 48.9 percent to 12.9 percent. Meanwhile, MFN tariffs for agriculture in Southeast Asia fell from 15.8 percent to 8.3 percent and those for manufactures from 14.7 percent to 7 percent. While the pace of tariff reduction in South Asia has been significant since 1990, overall tariff levels for agriculture and manufactures are higher than in Southeast Asia. Furthermore, while tariff barriers have generally fallen

Table 1.4 Trade barriers in South Asia and Southeast Asia

	Simple average MFN tariffs (%)				NTMs implemented 2009–13	Services Trade Restrictions Index, 2014
	Agriculture		Manufactures			
	1990	2013	1990	2013		Overall
<i>South Asia</i>						
Afghanistan	NA	6.3	NA	5.9	2	NA
Bangladesh	99.5	17.2	123.3	14.5	1	44
Bhutan	14.3	37.1	15.5	18.4	0	NA
India	77.5	28.8	84.1	9.2	337	66
Maldives	18.2	17.9	20.4	20.7	1	NA
Nepal	9.4	11.2	18.9	12.4	3	43
Pakistan	45.7	14.6	52.9	14.3	36	28
Sri Lanka	38.2	20.7	27.0	7.6	13	38
<i>Simple average</i>	43.3	19.2	48.9	12.9	49.1	43.8
<i>Southeast Asia</i>						
Brunei Darussalam	0.6	0.7	2.7	3.1	0	NA
Cambodia	17.8	16.4	16.5	14.2	3	24
Indonesia	20.1	4.9	12.4	7.2	75	50
Lao PDR	17.4	8.1	17.8	8.3	1	NA
Malaysia	9.0	2.4	14.8	8.3	16	46
Myanmar	8.2	8.3	5.1	5.2	4	NA
Philippines	23.3	8.9	19.6	6.0	6	54
Singapore	0.1	0.0	0.5	0.0	15	NA
Thailand	44.2	18.6	43.3	8.7	27	48
Viet Nam	17.7	14.8	14.4	8.6	39	42
<i>Simple average</i>	15.8	8.3	14.7	7.0	18.6	44.0

*Notes:*

For MFN tariffs, where data are not available, the most recent year is used.

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

A high score suggests greater restrictiveness.

Lao PDR = Lao People's Democratic Republic; MFN = most favored nation; NA = not available; NTM = non-tariff measure.

*Sources:* World Bank World Integrated Trade Solution, <http://wits.worldbank.org/WITS/> for MFN tariffs; Global Trade Alert Database, <http://www.globaltradealert.org/site-statistics> for non-tariff measures; World Bank Services Trade Restrictions Index Database, <http://iresearch.worldbank.org/servicetrade/aboutData.htm> (accessed 28 November 2014).

with the exercise of MFN rates, the application of preferential tariff rates, which are lower than MFN tariff rates, has not been significant. The effectively applied tariff rates on cross-regional trade by both regions are relatively close to the MFN applied tariff rates, which means that there is still ample room for reducing tariffs between the two regions as a means of boosting trade, FDI, and economic growth.

In addition, non-tariff measures (NTMs) can be reduced significantly. These are policy measures apart from customs tariffs that can potentially have an effect on trade costs by changing prices, quantity traded, or a combination of both. Table 1.4 also shows data on various types of NTMs (including bailouts/state aid measures, trade defense measures, import bans, import subsidies, sanitary and phytosanitary measures, technical barriers to trade, and local content measures). The data suggest that during the post-global era (2009–13) the numbers of NTMs implemented were 393 in South Asia compared with 186 in Southeast Asia. The largest economies in both regions are the most active in imposing NTMs: India (337), Pakistan (36), Indonesia (75), Viet Nam (39) and Thailand (27).

The services sector has grown rapidly in South and Southeast Asia; it accounts for over 50 percent of GDP in many South Asian and Southeast Asian economies and is making a growing contribution to trade in Asia (Noland et al. 2013). However, there is evidence of impediments to cross-regional trade and investment in services. Measuring services trade restrictiveness is a challenging undertaking beset by data gaps and subjective judgments. Bearing this qualification in mind, the World Bank's Services Trade Restrictions Index attempts to capture the policies and regulations that discriminate against foreign services or foreign services providers as well as certain key aspects of the overall regulatory environment that impact on trade in services. A high score indicates greater restrictiveness. Similar to the case of NTMs, the largest economies in both regions are particularly active in imposing restrictions on services trade – India (66), the Philippines (54) and Indonesia (50). Meanwhile, Cambodia and Pakistan have relatively low services trade restrictions, while other economies fall in between these extremes (Table 1.4).

Expanding broad-based FTAs between the two regions is a means to reduce barriers to trade and investment as well as to provide an environment for greater connectivity. In November 2012, ASEAN members and their FTA partners agreed to negotiate an RCEP. According to the guiding principles, the core of the RCEP negotiating agenda is expected to cover trade in goods, services trade, investment, economic and technical cooperation, and dispute settlement (RCEP Ministers 2012). There is also an open accession clause to enable participation of any ASEAN FTA partner, as well as other external economic partners, at a future date. Once

it is concluded, the RCEP will become the world's largest trading bloc and members are likely to experience notable economic benefits. However, there are many challenges to be addressed during the negotiations and afterwards, including the political challenge of respecting the central role of ASEAN in the RCEP negotiations amid the presence of major economies, gradually improving the coverage of WTO-plus issues, the risk that small and medium-sized enterprises may underuse RCEP preferences, and dealing with losses at the sector level within countries (Wignaraja 2014b). Currently, India is the only South Asian country to join the negotiations, but other South Asian countries may join the process in the future. Bangladesh expressed an interest in joining APEC once its moratorium on new members is lifted, which would allow it potentially to become part of Asia-Pacific regional integration initiatives.

## 1.4 SURVEY OF BOOK CHAPTERS

A number of barriers have limited deeper cross-regional integration and the potential benefits thereof. Hence, identifying these barriers and policies to reduce them needs to be a high priority on the agendas of constituent governments and regional institutions. Addressing the above constraints can be both technically and politically difficult. 'Low-hanging fruit' in the policy realm is easy to get at but actually generates little in return; the biggest pay-offs derive from deep integration that tackles 'high-hanging fruit'; this means NTMs, services, competition policy, intellectual property protection and politically sensitive goods such as agriculture. Petri et al. (2012) note that economic estimates of 'mega-regional' trade agreements such as the Trans-Pacific Partnership (TPP), the RCEP or the APEC-based Free Trade Area of the Asia-Pacific (FTAAP) critically depend on the template of integration used. In terms of the public goods of integration, this entails finding effective means of developing and financing cross-regional projects.

This book focuses not only on identifying the high-hanging fruit but also on finding the most effective ways to harvest them. These issues are covered in both the 'functional' chapters on land transport infrastructure, seaborne transport, trade and transport facilitation, infrastructure finance and institutional aspects, and in the country studies. In this section, we summarize the main results from the book chapters dealing with these issues.

## Functional Studies

### Chapter 2: Land-based cross-border transport infrastructure

Improving physical connectivity in South Asia and Southeast Asia is a key step to greater economic integration. In Chapter 2, Jean-François Gautrin provides a comprehensive assessment of potential highway and railroad connections between the two regions. Key physical barriers or hindrances to cross-regional trade are located mainly in Myanmar, the only land bridge between these regions, while other gaps are identified in Bangladesh, Cambodia, India, the Lao PDR and Thailand. The key issue with roads in most cases is the need to upgrade them, but the situation with railroads is more complex, as national networks are not connected, there are large missing sections, and there are other connectivity problems such as gauge size and braking systems. Major ports in the area also suffer from inadequate connectivity to road and rail networks. A number of key studies provide the bases for these assessments, including the ADB (2008, 2011, 2013), the Economic Research Institute for ASEAN and East Asia (ERIA 2010), the South Asian Association for Regional Cooperation (SAARC 2006) and the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP 2006, 2011).

Most trade between South Asia and Southeast Asia is by sea. However, with improved infrastructure and easier border-crossing procedures, the volume of goods and passenger traffic by land has the capacity to grow significantly. Empirical studies have confirmed that trade costs and infrastructure quality are strongly correlated with trade volume and economic performance. This chapter finds that the main constraints to physical land connectivity include: (1) high cost of land transport infrastructure and low volume of traffic; (2) policy problems associated with making regional (as opposed to national) links a priority; (3) lack of demand; (4) red-tape constraints affecting road corridors and border crossings; (5) the need to connect disjointed railway networks; and (6) financial constraints making it difficult to meet regional commitments.

Gautrin first reviews the history of initiatives to support improved land connectivity between South Asia and Southeast Asia. These include the Asian Highway network sponsored by UNESCAP, the India–Myanmar–Thailand trilateral highway project, the Mekong–India economic corridor (including a sea link from Chennai to Dawei and a land link from Dawei to Bangkok), the Kaladan multimodal transit transport project, the Delhi–Ha Noi railway link and the Singapore–Kunming Rail Link (SKRL).

Gautrin takes a two-step approach to identifying priority transport corridors and projects for both highways and railroads. Corridors are defined to link ‘gateway’ ports in the two regions. First, he identifies candidate

'port-to-port' through corridors linking the two regions. In South Asia, all candidate corridors originate from Kolkata and Chittagong ports in the Bay of Bengal. In Southeast Asia, candidate road corridors follow existing Greater Mekong Subregion (GMS) corridors with the eastern gateway port cities in Viet Nam being either Ho Chi Minh City, Da Nang or Hai Phong. The candidate corridors are then scored on criteria including total distance from gateway port to gateway port, number of border crossing points, overall quality of road infrastructure, level of security, resettlement and land acquisition problems, overall cost of road improvements; the priority corridors are then selected.

The second step is to identify priority projects for the high priority corridors. These projects are identified from existing pipelines of projects, including those of regional programs such as the ASEAN, GMS, SAARC, the South Asia Subregional Economic Cooperation (SASEC) and BIMSTEC, as well as national development plans. These projects are then scored on criteria including connectivity rationale, traffic and trade intensity, project recognition and acceptance, and project preparedness, socio-environmental problems, extent of benefit sharing among participating countries; the priority projects are then selected.

There is no rail connectivity between South and Southeast Asia, no connectivity within the GMS, and only limited connectivity within South Asia. There are, however, plans to construct missing links within the GMS and South Asia and also to connect the two regions. Providing full rail connectivity is costly and as yet, no time schedule is available for implementation.

The analysis of highways finds that the highest scoring corridor is the Kolkata–Ho Chi Minh City corridor passing through the 'Chicken's Neck' of northeast India, running through Myanmar, Thailand and Cambodia. Other high-scoring corridors include the Chittagong–Ho Chi Minh City corridor and the Chennai–Dawei–Ho Chi Minh City corridor. However, corridors running through Bangladesh score less well because of the lack of a transit agreement between Bangladesh and India. Priority highway projects were identified mainly in northeast India (Imphal–Moreh), Myanmar (Eindu–Myawaddy at the Thai border), Thailand (from the Myanmar border at Mae Sot to Tak) and the Thailand–Cambodia border (Aryanaprathet–Poipet). Corridors to Hai Phong and Da Nang were less attractive because of higher costs and lower traffic.

In terms of railway connections, the study underscores the challenges of increasing connectivity, owing to decreasing freight and passenger traffic, poorly maintained rail tracks and rolling stock needing replacement. Hence, the scoring analysis generates lower scores for railroads compared to highways, with no project receiving a high score. Similar to the case for highways, the highest scoring corridor was Kolkata–Ho Chi Minh City

passing via the Chicken's Neck in northeast India. Other high-scoring corridors included Chittagong–Ho Chi Minh City, Dawei–Ho Chi Minh City and Kolkata–Hai Phong (via Kunming in Yunnan Province, the PRC).

### **Chapter 3: Infrastructure to support seaborne trade between South Asia and Southeast Asia**

As mentioned above, sea trade is the workhorse of trade between the two regions. Therefore, any policies aimed at increasing trade between the two regions must address the various hindrances to such trade attributable to port infrastructure. In Chapter 3, David Wignall and Mark Wignall examine the seaports responsible for handling the majority of trade around the Bay of Bengal with a view to identifying projects that will contribute to improving maritime infrastructure and enable trade in and around the Bay of Bengal. The chapter reviews the nature of trade and how that trade could evolve, and analyzes the primary types of maritime trade around the Bay of Bengal and the ships that carry that trade. It also considers the changes that could occur with significant impact on trade patterns, taking into account the great potential for changes in trade patterns, particularly with respect to the Indian East Coast Corridor. It also examines the main ports on the Bay of Bengal to understand their history, regulatory regimes, purposes, capabilities, primary specifications, constraints, productivity, fitness for purpose when compared to other ports in comparable situations and their opportunities to improve and develop. Certainly, improvements in ports benefit trade in all directions, and cannot be ascribed specifically to trade between South Asia and Southeast Asia. However, it is likely that trade between the two regions would benefit at least proportionately from reductions in trade costs, owing to the proximity of the regions and the potential to expand supply chain networks.

The analysis of the nature of trade in the Bay of Bengal finds that container trade is the key to stimulate regional economic integration, as it accounts for most trade in merchandise goods, representing 40 percent of total trade by volume and a far higher percentage in terms of value. However, the container trade around the Bay of Bengal is relatively high cost, because it is almost exclusively based on transshipment of containers from small feeder ships to large efficient container ships at hub ports such as Colombo, Port Klang and Singapore. These high transport costs are a substantial impediment to the development of supply chain networks in the Bay of Bengal area. The key to reducing transport costs is to encourage increased calls to ports around the Bay of Bengal by large container ships and thus avoid costly transshipment of containers at hubs.

Wignall and Wignall review operating conditions at major ports in the Bay of Bengal. Aside from Chennai/Ennore, the major ports are too

shallow to allow access by large deep-draft container ships. They recommend investments to develop new deepwater ports at Kolkata, Chittagong and Yangon/Thilawa. Second, reducing the distance between dedicated and effective container terminals in ports around the Bay of Bengal by investing more in 'second-tier' ports would also increase the attractiveness of port calls by large container ships. Third, most Bay of Bengal ports have poor road and rail links to inland markets, and these need to be improved to lower costs and turnaround time.

Wignall and Wignall also consider more exotic port projects such as Dawei and Sittwe in Myanmar, which are linked to the Mekong–India corridor and the Kaladan project mentioned in Chapter 2. However, they find the rationale for such ports less compelling, given the lack of catchment areas to support trade in those ports.

#### **Chapter 4: Infrastructure finance and financial sector development for cross-border connectivity**

Asia's infrastructure financing needs are huge. Bhattacharyay (2012) estimates that South Asia and Southeast Asia will need at least \$3.6 trillion over the period 2010–20 in domestic infrastructure investment if they are to meet the needs of their growing populations and rising incomes. However, the underlying issue is not a shortage of money per se: according to data from the ADB, gross national savings in the two regions totaled \$1.36 trillion in 2011 alone, and there are plenty of funds in East Asian and developed financial markets looking for reliable long-term returns to meet a significant part of this financing requirement.

In Chapter 4, Shubhomoy Ray examines the challenges facing financing of infrastructure projects in the two regions and analyzes the various financing solutions and policy options that could be brought to bear. Regional and cross-border projects face particularly big challenges where spillover benefits can be substantial and unequal, and some countries involved may be more constrained than others in terms of financial capacity, institutional infrastructure and governance levels. Countries with less developed financial markets face funding gaps both in terms of the overall size of potential savings and the maturity and currency of investment flows. Although savings in the region as a whole are more than adequate to finance needed infrastructure investment, there are large disparities in the distribution of savings and financial development across countries that require cooperative measures and institutional developments to attract needed funds for investment projects.

Public funds can only cover a fraction of infrastructure projects, and the contributions from bilateral donors and multilateral institutions are limited, pointing to the need for substantial private sector investment.

Moreover, project lending by banks, the traditional workhorse of infrastructure finance, has a significant mismatch of maturity of assets and liabilities, and is facing increasing constraints. On the other hand, institutional infrastructure to support public–private partnership (PPP) arrangements is also inadequate in many cases. Such constraints are important in most South Asian countries, as well as Cambodia, the Lao PDR, Myanmar and Viet Nam in Southeast Asia. This calls for a broad collection of policies to encourage increased private sector financing of infrastructure projects. Financing options include governments, postal savings, multilateral development banks, sovereign wealth funds, export credit agencies, PPPs, international infrastructure funds and the private sector.

Another factor is the immaturity of the domestic capital markets in the two regions. Bond market investors in the region – especially in times of turmoil – tend to prefer plain investments, preferably with solid ratings. As the market is not sophisticated and contract performance risks are not appropriately defined, traditional project financing structures invariably receive sub-investment grade ratings, particularly when seeking financing on a non-recourse basis. Additionally, the illiquidity of regional bond markets, lack of market making, lack of yield curve and related benchmarks, and mistrust in financial reporting by corporates, keep institutional and retail investors away from corporate bonds which could finance developers' equity in projects. Finally, there exists a low level of regional financial integration, which suggests that there is untapped potential for cross-regional capital flows. For example, cross-regional portfolio investment remains limited.

Ray sees large potential interest in infrastructure finance investment products by institutional investors such as insurance companies and pension funds, which have long-term investment horizons and the capacity to accept higher risk in exchange for higher returns. However, he finds two main obstacles to increased participation by such investors: (1) regulatory restrictions in areas such as foreign ownership of infrastructure projects and restrictions on the risk classes in which institutional investors can invest; and (2) institutional constraints such as lack of market infrastructure and insurance mechanisms that reduce risk for private investors, immature regulatory frameworks, volatile and non-transparent political environments, and legal and regulatory changes that can substantially affect returns to investors.

Ray also finds that the role of the government institutions and the parastatals in infrastructure financing will have to be supplemented by multilateral development banks (MDBs) such as the World Bank and ADB. Multilateral development banks have an important role to play in narrowing the funding gap in national and cross-border infrastructure projects, as

well as in influencing the policy environment, impacting procurement processes and providing risk covers to private sector developers. Multilateral development bank support can take numerous forms, including augmenting or supplementing national budgets through sovereign lending, leveraging private sector participation through guarantees covering political and credit risks, financing feasibility studies through technical assistance and providing project-structuring support. In an increasingly complex financing and political risk environment, MDBs are also expected to play a critical role in improving the regulatory environment, supporting transfer and diffusion of technology, and improving business and governance practices, particularly in emerging economies such as those in the ASEAN. As non-conflicted transaction facilitators, MDBs can play the key role of being a coordinator for regional integration among multiple stakeholders. There is also a greater potential role for regional infrastructure funds. Ray notes that the ASEAN Infrastructure Fund is already active in this area, and could be expanded to become an Asian infrastructure investment fund.

#### **Chapter 5: Policies to enhance trade facilitation**

Trade facilitation includes all factors affecting the time and monetary cost of moving goods. Trade facilitation measures are critical to ensure the benefits of infrastructure investment result in an actual reduction in trade-related costs. While customs activity has the most visible impact on increasing the time and cost of trade moving through borders, this can often mask the adverse effect of other agencies and operators in raising border transaction costs. Most trade between South Asia and Southeast Asia will continue to move by sea. Hence, port facilitation covering all the processes between the ship's arrival and the goods leaving the port – and vice versa in the case of exports – should be encompassed within the scope of trade facilitation. Similarly, the means of transport across land borders, often referred to as transport facilitation, is also included. In Chapter 5, Anthony Bayley assesses the current state of trade facilitation in the two regions and important measures to encourage further integration. He notes that conditions of trade facilitation vary markedly by country, with some, such as Singapore, Malaysia and Thailand, scoring highly in international rankings, while others score poorly, including Bangladesh, Cambodia, the Lao PDR and Myanmar, which makes it difficult to generalize.

Bayley identifies the following major trade facilitation areas that need to be addressed in South Asia and Southeast Asia: (1) excessive documentation required by the customs, immigration, quarantine, and security organizations for clearance and processing purposes; (2) inadequate implementation of modern customs procedures; (3) limitations to the application of information and communication technology, particularly

in relation to customs operations; (4) the absence of national and regional single windows; (5) lack of transparency and unclear import–export requirements; (6) legislative constraints related to customs; (7) compliance with national technical standards, including the diverse conformity assessment practices and the persistent use of individual standards and approaches in different countries; (8) poor border infrastructure; (9) delays at ports, through which most regional trade takes place; (10) delays in transit traffic to landlocked countries; (11) transport facilitation issues related to cross-border transit, with negotiation of through-transport arrangements having proved difficult within and across regions; (12) governance issues, particularly in regards to rent-seeking and corruption at the border; and (13) lack of effective consultation mechanisms to improve trade facilitation.

Awareness of the importance of trade facilitation has increased dramatically over the last decade in both South and Southeast Asia. National governments and the major MDBs, such as the Asian Development Bank (ADB), have become increasingly active in formulating initiatives to help eliminate many of the non-trade tariff barriers (NTBs) related to the physical movement of trade. In particular, the finalization of the Trade Facilitation Agreement at the Bali Ministerial Conference held in December 2013 – which at the time of writing has yet to be ratified – focuses on resolving many of these issues. This reflects a clearer understanding of the interrelation between trade growth and trade facilitation.

Some trade facilitation measures have been initiated at the multilateral, regional and subregional levels involving accelerating the modernization of customs administration, for example, the Revised Kyoto Convention, the World Trade Organization Customs Valuation Agreement and the implementation of the World Customs Organization's Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework), the ASEAN Single Window, and the ADB-supported GMS program on trade and transport facilitation. However, not all countries in the two regions have signed the Revised Kyoto Convention as yet.

The ASEAN Single Window initiative is now being implemented and member countries are engaged in realizing this initiative. Country-level trade facilitation programs are also being undertaken in South Asia to accede to the Revised Kyoto Convention and to modernize customs management and administration. The ADB is actively involved in providing support for regulatory reforms aimed at improving customs operations. Progress by country is uneven, though. Bayley argues that regional economies should consider the development of a regional single window initiative, similar to the ASEAN Single Window but also covering the South Asian region (or possibly SASEC alone).

Transit is likely to become an increasingly important issue in connecting the two regions, both for inland and international transit. On the one hand it will be critical to move shipments from the frontier, be it a port or land border, to an 'inland' point for clearance. This is to eliminate congestion at the frontier, to move cargo through countries to serve landlocked nations, or ultimately to undertake multi-country journeys such as from Thailand to India. In some countries, there are inland transit arrangements, and where arrangements do exist they are often suboptimal in expediting transits. For either region to be able to cope with the predicted growth, it will be essential to develop mechanisms to facilitate the movement of uncleared cargo away from the immediate border interface.

Bayley expects that the development of trade facilitation will follow a pattern of deepening regional cooperation and enhancement but significantly differing levels of progress will be achieved by individual countries in the two regions, with the most developed trade facilitation countries in Southeast Asia advancing more rapidly than their less developed regional partners. In effect, the best are getting better and the gap between the best and many of the poorer countries is widening, mainly due to the magnitude of differences in resources, funding and levels of automation. Many regional initiatives are programmed to provide support to help close that gap by assisting the less developed countries to improve their national trade facilitation environment. For example, in order to pursue the goal of through-land transport between the regions, specific assistance may be required for Myanmar, whose trade facilitation environment is not currently compatible with its trading partners to the east or west. Also, there should be a gradual shift of emphasis from customs reforms toward addressing more of the non-customs issues, such as sanitary, quarantine, phytosanitary, veterinary and trading standards.

### **Chapter 6: Implementation challenges and coordination arrangements**

Building institutions that will improve cross-regional coordination and address coordination gaps in areas such as cooperative planning and implementation processes is a major challenge. National-level coordination alone is already an arduous process, but problems rise geometrically when coordination policies need to be developed across two or more countries since these involve the coordination of diverse political and legal systems, economic institutions and even sociocultural traditions.

In Chapter 6, Moe Thuzar, Rahul Mishra, Francis Hutchinson, Tin Maung Maung Than and Termsak Chalermphanupap examine the implementation challenges and coordination arrangements necessary for connecting South Asia and Southeast Asia. They provide a background on the political economy and sociocultural implications of the different regional

and subregional arrangements and their connectivity initiatives. These different arrangements include the economic integration initiatives under the ASEAN and the SAARC and their various subregional programs and arrangements including the SASEC, BIMSTEC and GMS.

The ASEAN has embraced connectivity as a vehicle for regional integration, particularly in the economic sectors. Having announced an ambitious goal to achieve a single market and production base as part of an integrated ASEAN Community by 2015, ASEAN policymakers have recognized the importance of internal and cross-border connectivity, in order to link to global supply chains. Within the ASEAN, the GMS group of countries is perhaps most relevant for cross-regional connectivity, since it includes those countries closest to South Asia, and it has a highly developed program of economic corridors and infrastructure projects, some of which have the potential to be extended to South Asia.

The SAARC is South Asia's institutional counterpart to ASEAN, though it is less advanced. Its aspiration to achieve a South Asian Free Trade Area is nowhere near the implementation level of its Southeast Asian equivalent and it has no equivalent of the ASEAN Economic Community (AEC). However, similar to the ASEAN, there are institutional arrangements for shared responsibility (and ownership) in regional cooperation. Within the SAARC, the SASEC group of countries is the equivalent of the GMS, since it mostly represents countries close to Southeast Asia; it is a 'functional' entity focused on infrastructure, and it has ADB as its secretariat. Therefore, increased cooperation between the GMS and the SASEC is a promising route to promote greater integration.

The BIMSTEC also provides a key stepping-stone for closer ASEAN–South Asian connectivity, since it is the main regional grouping that straddles both regions. Bangladesh, India and Myanmar, in particular, have a common interest to initiate and support BIMSTEC programs in their shared border areas, particularly for the necessary infrastructure, both hard (transport and energy) and soft (trade and transport facilitation) connectivity.

Risks to and uncertainties regarding regional integration implementation include: (1) political difficulties associated with economic integration, particularly in South Asia; (2) uncertainties in Myanmar, which is a key country linking the two regions but still at an early stage of its reform program; (3) social issues related to integration – including illegal immigration – and the potential for increased illegal cross-border trade; (4) security considerations, such as the anti-Indian tribal insurgents that have been an irritant to India–Myanmar relations; (5) unequal distribution of benefits deriving from connectivity projects; and (6) the need to have measures to compensate sectors or regions that lose from greater integration.

To improve implementation of economic cooperation, the authors argue that it is important to: (1) develop public messaging on the benefits of connectivity to complement regional (local) development projects; (2) align national priorities with regional and bilateral undertakings; (3) dovetail physical and institutional connectivity needs, for example, development of communication and transportation links in project areas should be prioritized under national and bilateral plans; (4) achieve rapid implementation of India's Northeast Region Vision 2020, which provides eight recommendations to connect northeast India with Southeast Asia; (5) provide broad support for Myanmar's economic reforms, especially in the border areas; and (6) include state governments in plans designed to advance connectivity.

### **Chapter 7: Economic implications of deeper South Asian–Southeast Asian integration: a CGE approach**

Assessing the economic effects of regional economic integration – be it market- or policy-led – is complicated. In addition to the many relevant economic variables that need to be considered, formal preferential trade agreements such as FTAs are inherently 'second best,' that is, they are characterized by both positive and negative efficiency effects. This suggests that FTAs may or may not be beneficial to the integrating economies or even to themselves. Empirical estimation, which is also complicated, is required in order to assess the merits of an agreement.

Would it make sense to forge a South Asian–Southeast Asian FTA? In Chapter 7, Ganeshan Wignaraja, Peter J. Morgan, Michael G. Plummer and Fan Zhai assess how the potential effects of economic integration on the region's economies might be estimated. They then generate estimates of the potential gains and losses from South Asian–Southeast Asian economic integration using an advanced computable general equilibrium (CGE) model. They estimate that the potential gains are large, assuming that both soft (for example, trade facilitation) and hard infrastructure are put in place to reduce inter-regional trade costs, which currently are high.

The study considers four scenarios for cross-regional integration. For example, if the two regions succeed in dropping inter-regional tariffs, reducing NTBs by 50 percent and decreasing other trade costs by 15 percent – which the study suggests is ambitious but nevertheless attainable – welfare in South Asia would rise by \$375 billion (8.9 percent of GDP), and in Southeast Asia by \$193 billion (6.4 percent of GDP) by 2030, relative to the baseline. These gains will be driven by rising exports and competitiveness, particularly for South Asia, whose exports would rise by almost two-thirds. Hence, the study underscores that relative large investments in cross-regional connectivity are likely to be justified.

In addition, it emphasizes that the governments of the regions' economies need to take into account the inevitable problems that arise in the integration process, for example, the effects of structural change on the most vulnerable workers and sectors. Initiatives related to economic integration also need to be nested in the context of other social priorities, such as food security and the protection of migrant workers.

## Country Studies

### **Chapter 8: Myanmar: the land bridge**

In Chapter 8, Hector Florento and Maria Isabela Corpuz point out that land-based connectivity between South Asia and Southeast Asia must go through Myanmar, the only land bridge between the two regions. Major land routes have been identified in Chapter 2 but there are critical gaps that exist, mainly in Myanmar. This is especially true for the rail sector. For the road sector, gaps usually stem from poor quality roads that cannot reliably accommodate all-weather travel. Strengthening physical connectivity requires a multimodal perspective, including the development of non-land transport modes such as air and maritime transport. The implications for gas and oil shipments that can be transported by pipe, ship, rail and, in some cases, road also need to be considered.

For Myanmar, analyzing the costs and benefits and presenting an economic rationale for public sector funding of key projects will be crucial in prioritizing major projects according to national development objectives, getting political buy-in, helping ensure value for money and facilitating bilateral assistance plans. At the regional level, an analysis of costs and benefits will help identify the potential welfare gains from connecting South Asia and Southeast Asia, and how Myanmar could get a proportionate share based on its contribution to establishing physical connectivity. The importance of regional cooperation to support regional transport projects should not be overlooked, to ensure that the economic benefits outweigh the costs and that regional public goods will be created.

### **Chapter 9: India: building connectivity under the Act East Policy**

In Chapter 9, Prabir De finds that India's regional integration with Southeast Asia has been advancing well and several projects are currently being implemented. India's policy for regional connectivity is based on two pillars: northeast India for multimodal and intermodal operations, and southern India for multimodal operation. De presents India's broad proposals on connectivity projects with Southeast Asia, and policy recommendations to strengthen connectivity in Asia in general and between the ASEAN and India in particular. He argues that enhancing connectivity

between South Asia and Southeast Asia is a multifaceted task that will require the implementation of strong policy initiatives but with significant attendant benefits especially for industrial development in India and its trade potential.

While prospects for India–Southeast Asia trade have grown rapidly, challenges too have become more complex, making it an under-performer in realizing trade potential. Non-tariff policy barriers have gained importance as tariff-based barriers to trade have gradually declined. Among others, shortcomings in connectivity undoubtedly play a critical role in the failure of India to reach its trade potential with the ASEAN. India and Southeast Asian countries are committed to achieving greater trade volume through policy initiatives such as the ASEAN–India FTA and the RCEP – in which India is the only South Asian negotiating member – with expanding trade facilitation initiatives in particular holding much promise. Both India and the ASEAN require a shared strategic vision, political will and strong commitment among countries, as these will be key to success of connectivity projects in the region.

#### **Chapter 10: Thailand: key subregional hub**

In Chapter 10, Suthiphand Chirathivat and Kornkarun Cheewatrakoolpong assess Thailand's potential connectivity with South Asia. Thailand has been an active member of the ASEAN from the beginning. With the dramatic transformations taking place in the ASEAN – particularly in terms of the AEC and developments in mainland Southeast Asia, including the latest changes in Myanmar – Thailand has a natural advantage in regional community-building. Contrary to the Cold War period, the country's geographical location and development experience endow it with a strategic comparative advantage in linking its neighboring countries in the GMS and beyond. Unique opportunities are especially evident in respect of projects dealing with physical connectivity.

The authors review the current state of Thailand's intra-regional trade, physical connectivity, trade facilitation, energy cooperation and infrastructure funding, for which there are planned projects in all areas, with potential impact on Thailand and its links to the Southeast Asian region and South Asia. However, Thailand's political instability has impeded the progress and implementation of such projects. They also examine the current financing mechanisms for Thailand's infrastructure projects, which rely heavily on public spending. They provide suggestions for strategies to promote physical infrastructure, trade facilitation and energy cooperation between Thailand, the rest of the ASEAN, and South Asia.

**Chapter 11: Bangladesh: perspectives on deepening cross-border links**

In Chapter 11, Mustafizur Rahman, Khondaker Golam Moazzem, Mehruna Islam Chowdhury and Farzana Sehrin conclude that economic integration between Bangladesh and its partners in South Asia and Southeast Asia is seriously inhibited by the poor state of transport connectivity. Their study reviews connectivity initiatives of Bangladesh and the two neighboring regions and proposes ways to deepen regional and inter-regional connectivity. Since the early 1990s, as a consequence of their trade-led growth strategies, South Asia and Southeast Asia have emerged as important economic partners of Bangladesh, both in terms of export destination and import sourcing. However, constraints 'at the border' and 'behind the border' have tended to undermine the prospects of reaping the benefits accruing from closer economic cooperation.

There is now an increasing realization among policymakers in Bangladesh of the importance of transport integration as an effective tool for market integration, and for attracting efficiency-enhancing and market-seeking investment. This changed perspective has been reflected in Bangladesh's long-term development policies. The authors identify cross-border initiatives with Bangladesh's involvement particularly at the bilateral, sub-regional and regional levels. Some of these initiatives are also integrated with Asian-wide broader connectivity particularly through the Asian Highway and Trans Asian Railway initiatives discussed in Chapter 2.

Ongoing initiatives include construction and upgrading of multi-lane highways and railways, road and rail bridges, procurement of locomotives and wagons, and construction of internal container river ports. However, progress has been slow and cross-border transit remains an unaddressed issue. A consensus is emerging regarding the need to adopt standard operating procedures and harmonize standards and customs procedures, including service charges and user fees for transit facilities. Additionally, significant investment will be required for trade facilitation and to upgrade border trade facilities at land ports, inland waterways and seaports.

**Chapter 12: Nepal: a connectivity-driven development strategy**

In Chapter 12, Pradumna B. Rana and Binod Karmacharya make the case for a connectivity-driven strategy for Nepal. Nepal's lackluster economic performance during the post-conflict period (that is, after November 2006) has been driven by remittances from the export of labor services and the improved performance of the agriculture sector, which is still very much weather dependent. The authors argue that improved connectivity within Nepal and cross-border connectivity with its neighbors in South Asia, the ASEAN and the PRC can convert Nepal from a landlocked into a 'land-linked' state, which in turn could be a crucial 'engine of growth' for the

country. They argue that such a development strategy is not new for Nepal, as in the past it was strategically located on the Southwestern Silk Road. A number of factors have revived the case for making Nepal a land-linked state in Asia. Nepal has adopted a multi-track approach to promoting regional cooperation and integration in connectivity with its neighbors. However, a lot more needs to be done, especially in the context of the difficult political situation in the country, with a clear role for development assistance partners to play in the country's future development.

### **Chapter 13: Sri Lanka: regional sea transport hub**

In Chapter 13, Dushni Weerakoon and Nipuni Perera analyze Sri Lanka's pivotal role as a hub port for connecting South Asia and Southeast Asia. Colombo is the only port in the Bay of Bengal that approaches global standards in terms of operational efficiency and throughput. Investments to expand capacity at Colombo port are underway as part of Sri Lanka's renewed efforts to develop its infrastructure following the long internal separatist conflict that ended in 2009. However, despite significant improvements in physical infrastructure connectivity, Sri Lanka has made only limited headway in strengthening its trade and investment links with the rest of the region. Moreover, the country has seen a sharp decline in its overall ratio of exports to GDP ratio, which is worrying in view of the growing external debt financing of many large infrastructure projects through state-led investment initiatives.

The authors conclude that Sri Lanka needs to focus on two priority areas: (1) engaging private investment in infrastructure by strengthening the country's institutional and regulatory environment; and (2) implementing a more open and strategic trade policy geared to enhancing regional integration efforts. Regarding the latter, Sri Lanka has not undertaken to enter into fresh agreements since the SAFTA came into force in 2004. In particular, expanding the current bilateral free trade agreement with India into a broader agreement to cover services and investment has been kept on hold since 2008. They argue that Sri Lanka must tap into strategic economic integration opportunities, particularly with India, and revise the stalled CEPA process.

## **1.5 SUMMARY**

The wealth of analysis in each functional and country chapter includes policy analysis and recommendations for policymakers, bilateral and multilateral donors, and other development partners and stakeholders to improve South Asian–Southeast Asian connectivity. These

recommendations address both hard infrastructure (land and sea transport) and soft infrastructure (trade facilitation, finance and institutions).

Regarding hard infrastructure, the analysis identifies several highway and railroad corridors and associated projects that have the best prospects for augmenting connectivity via land routes. For highways, the Kolkata–Ho Chi Minh City route through the Chicken’s Neck in northeast India and the Chittagong–Ho Chi Minh City route receive the best scores, owing to the short distance and low improvement costs for the latter and trade and supply chains that could be improved through the former. For railroads, the routes from Kolkata to Ho Chi Minh City and to Hai Phong via the PRC have the best prospects. However, connectivity through rail is more challenging, with many missing links and various technical incompatibilities. Therefore, it may be preferable to place priority on upgrading national rail networks first before trying to link them up.

Sea transport is still the workhorse of cross-regional trade, and reducing shipping costs and delivery times holds the most promise for promoting trade between the two regions, although such benefits will obviously accrue to trade with other regions as well. In view of the importance of efficient container trade for developing supply chain networks, large-scale deepwater ports should be constructed at Kolkata, Chittagong and Yangon/Thilawa in order to encourage more direct calls by large container ships. This should be combined with improving road and rail connections with domestic catchment areas.

In addition, there should be policies to support the development of smaller container terminals in ports on the east coast of India, reform cabotage laws, particularly those in India, to encourage the development of coastal shipping (but with careful attention to local politics), and review competition laws and their application to the container shipping sector with a view to encouraging the development of robust competition on cost and service between shipping lines.

Regarding finance, a broad suite of measures is needed to attract sufficient funds for infrastructure financing in the region. At the national level, development of domestic bond and equity markets needs to be encouraged to supplement the role of the banking sector. Also, the environment for attracting private funding for infrastructure needs to be improved. This includes strengthening the frameworks for PPP projects and providing a greater range of government guarantees against political and other risks where needed. At the regional level, restrictions on capital flows and foreign ownership need to be relaxed in an orderly way, and the options for international financing by regional infrastructure funds and sovereign wealth funds need to be widened. Restrictions on the investment vehicles allowable for long-term institutional investors such as pension funds and

insurance companies also need to be relaxed, and instruments and policies to enhance the risk characteristics of project bonds should be introduced. In all of these measures, MDBs can play an important advisory and coordinating role.

Improving trade and transport facilitation also requires a comprehensive approach. Perhaps the single biggest barrier is excessive paperwork and reliance on physical paper processes for customs clearance. Adoption of information and communication technology-based procedures such as the National Single Window and regional Single Windows is needed. Also, cross-border transit agreements can expedite the physical flow of goods across borders. In some cases, physical infrastructure at land borders also needs to be improved. National and regional institutions need to be refined and adjusted to promote regional integration. Greater cooperation between the GMS and the SASEC could help to jump start cross-border infrastructure projects. Since the BIMSTEC is the only regional organization that currently straddles the two regions, increased cooperation between it and other regional institutions could make an important contribution. Most importantly, there needs to be greater alignment of national and regional priorities for infrastructure and trade policy, otherwise it will not be possible to achieve 'buy-in' by the relevant national authorities.

Given differences in benefits, costs, incomes and political priorities, regional compensation mechanisms will also need to be developed to mitigate the costs borne by sectors and regions that may suffer from increased integration. Other political- and social-related aspects of integration, such as food security and migration, are also relevant as policymakers envision new forms of economic integration. Economic cooperation can actually enhance food security for integrating countries, and put constraints on domestic initiatives that could potentially harm partner countries. Very few regional cooperation initiatives include labor flows, particularly in the developing world, and it is unlikely that they would be included in any formal trade agreement between South Asia and Southeast Asia. Yet, from a policy point of view, it is important to anticipate rising migration by jointly advancing programs and initiatives that protect and promote the rights of migrant labor.

If substantial reductions in tariffs, non-tariff barriers and transport costs can be achieved by adopting these policies, the analysis finds that there are potentially large gains from increased economic integration of South Asia and Southeast Asia, especially for South Asia. It concludes that, the deeper the integration template, the greater the gains via efficiency and productivity improvements. In the deepest case of integration considered, welfare in South Asia would rise by \$375 billion (8.9 percent of GDP), and in Southeast Asia by \$193 billion (6.4 percent of GDP), by

2030, relative to the baseline. These results support the view that substantial investments in cross-regional connectivity would be justified.

However, the results also underscore that the dramatic increases in efficiency from economic integration derive from structural changes, which can change the distribution of income in ways that could exacerbate existing problems, such as the trend toward rising income inequality in many Asian economies since the global financial crisis. This does not imply that the initiatives should not be embraced; it only emphasizes the importance, as discussed above, of active government policies to facilitate economic integration and ensure that the gains are widely spread and the big ‘winners’ of integration will compensate the most vulnerable that lose from it.

## NOTE

1. This report follows the convention that South Asia and Southeast Asia are two regions of Asia. South Asia includes Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka, while Southeast Asia includes Brunei Darussalam, Cambodia, Indonesia, the Lao People’s Democratic Republic (Lao PDR), Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.

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