

SOUTH ASIA'S FTA STRATEGIES AND OPTIONS

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Introduction

The intertwining of national interests at the multilateral and regional level has acquired a new intensity in the 1990s. A trend that has rapidly gained momentum is the proliferation of regional and bilateral trade agreements among countries that reduce barriers to trade on a reciprocal and preferential basis for each other. With the emergence of powerful trading blocs like the EU and NAFTA over 60 per cent of world trade is conducted on a preferential basis rather than on MFN basis. The consequent diversion of trade and increasing intra-regional trade has an adverse affect on the growth process in the regions that are not a part of these trading blocs.

Asian countries have followed multi - lateralism rather faithfully. In South Asia, while South Asia Preferential Trading Arrangement (SAPTA) has been there for some time, the emphasis was on broader issues of regional cooperation rather than concrete measures of trade liberalization. The stance has now changed. Regional economic integration in the geographical, social, historical and culturally contiguous South Asia is being pursued seriously. The South Asian Free Trade Area (SAFTA) Agreement was implemented in July 2006.

This paper undertakes an analysis of South Asia's FTA strategies in the context of the region's potential for trade and investment expansion. The focus of the paper is on regional agreements in South Asia. The paper also highlights India's predominant economic position against a profile of South Asia's economic asymmetry following which the paper considers the possibility of India as the anchor economy that can connect South and East Asia to constitute an Asia-wide trade bloc that may provide the member countries with a greater economic and strategic advantage than South Asia in isolation.

Intra-regional Trade in South Asia: Current Status and Potential

For the purpose of this paper South Asia is defined as comprising the seven SAARC¹ member nations i.e. Bangladesh, Bhutan, India, Pakistan, Sri Lanka and Maldives. The economic profile of the region is presented in Table 1. It is evident that South Asia compares reasonably well with other regions in terms of GNI (PPP) and per cent rate of

growth over 2002-2003. South Asia has the third largest GNI in PPP terms after East Asia and Latin America and has registered the second highest growth rate next only to East Asia.

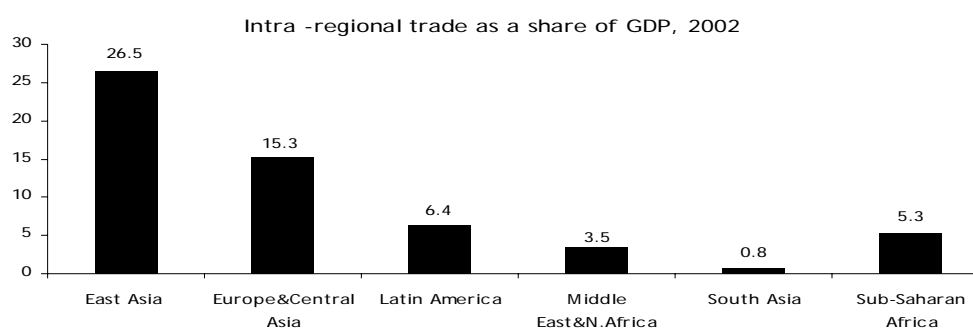
Table 1: South Asia - The Region: A Comparative Perspective

	Pop(mill)	GNI (\$bn)	GNI (PPP)	GNI PC (\$)	GDP Growth (%) 2002-2003
East Asia	1,855	1988.2	8542	1070	8.1
Europe & C. Asia	472	1216.5	3555	2580	5.8
Latin America	533	1747.4	3801	3280	1.6
Mid. East & N. Afr.	312	744.2	1826	2390	5.7
South Asia	1425	733.2	3761	510	7.5
Sub Saharan Africa	705	351	1236	500	3.9

Source: WDI 2005.

Given its growing economic strength South Asia has the potential to form a regional economic grouping. Intra-regional trade in South Asia has however been very low. As a percentage of total trade volume intra-regional trade has remained around 2 per cent since 1980 (Wilson and Otsuki, 2004)². Among all regions South Asia is the least integrated when measured as a share of GDP (Fig. 1). Intra-regional trade in South Asia is only 0.8% of GDP, a fraction of East Asia's nearly 27% of GDP and is in fact even below that for sub-saharan Africa.

Fig. 1



Source: Roy (2005).

Intra-regional trade in South Asia has languished owing to a combination of politics and protectionism. In the late 1940s when most South Asian countries were part

of one political entity – British India - trade among them was sizeable. But owing to ensuing political tensions between India and Pakistan the trade shares declined in the post independence era. In addition, for a long time all countries in the region have pursued economic development by adopting import substitution rather than export promotion strategies, thus keeping trade as a proportion of national production low.

Both these factors are changing for the better now and countries of South Asia are willing and ready to increase regional cooperation. India and Pakistan are resolving their differences through diplomatic channels. All countries are opening up their economies to global trade. The import substitution strategy was first abandoned by Sri Lanka and then by others in the 1990s. India has significantly reduced trade weighted tariffs in 2005 and 2006 and aims at aligning its tariff structure with that of ASEAN.

It has been sometimes argued that the low level of intra-regional trade for South Asia does not augur well for regional economic integration. The intra-regional trade level in South Asia does not compare well with other successful regional arrangements such as the EU and NAFTA. These arrangements have had levels of intra-regional trade that help characterize these arrangements as ‘natural trading partners’³. At the inception of EU intra-regional trade was around 65% and for NAFTA it was around 42%. Even for trade blocs that comprise developing countries, such as Mercusor, intra-regional trade stood at 13% prior to the launch of the arrangement in 1991⁴.

In addition to the fact that there is no a priori theoretical basis to expect that PTAs with higher initial intra-regional trade are more likely to be welfare improving, there are several other reasons to treat this argument with some caution or maybe even dismiss it. Official trade figures understate the extent of intra-regional trade in South Asia. Several studies point out to the considerable amount of ‘informal’ trade taking place in the region not only to evade high tariffs prevalent in the region but also to carry out some trade that would not have been permitted at all. Pitigala (2000) reports that once the informal trade is added, intra-regional trade of Bangladesh jumps from 17.7 per cent to 21.8 per cent in 1995 and for Sri Lanka in the same year the increase is from 11.4 per cent to 14.4 per cent.

Further, Batra (2004) has used the augmented gravity model to estimate the trade potential for India with its trading partners in the world and specifically within some regional groupings like the SAARC. The model explains bilateral trade as a function of bilateral distance, economic size, contiguity and cultural proximity as indicated by a common language and colonial past. The model is estimated using GNP

both in terms of purchasing power parity and current international US dollar value. For both versions of the model, the estimates indicate positive trade potential for the SAARC region as a whole. The positive trade potential is mainly on account of potential trade between India and Pakistan in the former estimation and only on account of India - Pakistan trade potential in the latter. The potential trade between India and Pakistan is estimated to be US \$ 6.5 billion more than the actual trade between these economies when the model is estimated using GNP current international US dollar value.

The success of a regional bloc is also very often considered to be positively related to the diversity in the structure of comparative advantage of member nations. Several earlier studies have analyzed the nature and extent of revealed comparative advantage of the South Asian economies. Most of these studies are suggestive of a similarity in the pattern of comparative advantage and export interests across South Asian countries. However in comparison with other South Asian countries the range of products over which India has comparative advantage is somewhat broad. According to Kemal et al (2000) study for the period 1985-1995, India has reasonable potential to meet the import needs of countries in the South Asian region. India can export a variety of products ranging from various food items to machinery and transport equipment to other countries in South Asia. The degree of trade complementarity has increased for Bangladesh and India. A reasonable compatibility is also indicated between the trade structures of Sri Lanka and India. Interestingly, relative to other countries in the region, complementarity between India and Pakistan is higher.

Batra and Khan (2005), show that India has comparative advantage in 41 out of 97 sectors of the HS-2 classification. On analyzing the correspondence between the structure of revealed comparative advantage for India and imports of the other SAARC member nations it is evident that India can meet the import demand for the region. There are ample examples to support this -Pakistan imports cereals, milling products, malts, starches, sugars and confectionary, textiles –all commodity groups where India has a high revealed comparative advantage in the global market and Pakistan high imports. However none of these products are currently being sourced from India.

Gains from regional economic integration are possible through intra- industry trade. Scope for vertical integration of different stages of production among the South Asian nations exists in sectors like textiles, leather goods, light engineering, rubber products, automobiles and exploitation of bio-resources⁵. The proportion of intra-

industry trade in total trade is however low (Kemal, 2000). The exception is India – Nepal intra-industry trade that is about 14 per cent of their bilateral trade.

There is potential for efficiency seeking restructuring in South Asia. Illustrative examples of this potential for restructuring in South Asia are available. A recent study by Das (2004) shows how free trade regime under the India-Nepal bilateral free trade arrangement has facilitated the restructuring of production by certain companies that have shifted production base in Nepal for serving the north Indian market as also for third country exports. Among others, examples include Dabur, India setting up its production unit for fruit juices in Nepal. Evidence towards efficiency seeking restructuring is also evident from the India- Sri Lanka FTA. These include Ceat India, production of automotive tyres in Sri Lanka for the markets in South Asia and beyond. While these cases are an outcome of India's bilateral agreements, they help reveal how an FTA with a liberalized investment regime can induce a spate of efficiency seeking industrial restructuring through intra-South Asian FDI flows. Potential for such flows exists in both the textiles and clothing sector.

Regional Economic Integration Attempts in South Asia

Over the past 15 years South Asian countries have tried to increase intra-regional trade. The increase has however been more on account of the changes in macroeconomic policy of the member nations rather than the formal trade agreements. Thus far there have been two formal agreements at the regional level in South Asia. These are SAPTA and SAFTA.

South Asian Preferential Trading Arrangement (SAPTA)

The South Asian Preferential Trading Arrangement (SAPTA) was signed in April, 1993. The Agreement became operational in 1995. The SAPTA Agreement provided for the exchange of tariff preferences among member nations without commitment that such exchange would be carried out on a scale that turns the region into a free trade area by a specified date. As such therefore the agreement could not be termed as a South Asian *free trade area/agreement*. The agreement made a distinction between least and other developing member countries, provided for special and differential treatment for the LDC members and also included a regional 'MFN' provision. The rules of origin (RoO) provisions have been a contentious issue among member nations. After much debate the RoO allow for 40 per cent local content requirement for non-LDC members

and 30 percent for the LDC members and the 'cumulative' origin requirement of 50 per cent.

Following SAPTA's establishment, three rounds of preferential tariff reductions were implemented. Concluded in 1995 SAPTA-1 covered only 6 per cent of traded goods (226 products at HS-6 digit level). The important issue of non-tariff barriers was deferred. SAPTA-2 concluded in 1997 and was more ambitious as it covered 1800 products at the HS-6 digit level. It also incorporated provisions about easing non-tariff barriers. SAPTA-3 was signed in 1998 and was most ambitious, covering 2700 items. The SAPTA-4 round though initiated was put on hold owing to the political situation in Pakistan.

Despite three rounds of preference negotiations the arrangement has remained ineffective. Two main reasons have been cited for SAPTA's inability to raise intra-regional trade levels by substantial amounts. These are: a) at the time of implementation of SAPTA the region was characterized by highly restrictive economic and trading regime and more importantly b) the goods for which trade preferences were offered did not constitute a significant proportion of total number of goods traded. Mukherjee (2000) estimates that the proportion of intra-regional imports covered by the SAPTA preferences was the highest for Pakistan (39.6%), followed by Nepal (35.2%), India (30%), Bhutan (17%) and Sri Lanka (12%). The import value coverage for Bangladesh and Maldives was marginal.

Nevertheless the slow progress of the multilateral negotiation process and the relative success of the India-Sri-Lanka Bilateral FTA⁶ has given the impetus to a more serious consideration, especially by India, of the regional option for a free trade area in South Asia. The SAFTA Agreement that was ratified in January, 2006 and implemented on July 1, 2006 aims at turning the region into a free trade area.

South Asian Free Trade Area (SAFTA) Agreement

The stated objective of the SAFTA Agreement is to "strengthen intra-SAARC economic cooperation to maximize the realization of the region's potential for trade and development of their people". The SAFTA agreement covers tariff reductions, rules of origin, safeguards, institutional structures and dispute settlement. SAFTA members have committed to a ten-year phase out of tariffs from July 2006. Reductions will proceed in two stages but at a different speed for the least developed members and non-least developed members.

The SAFTA tariff reduction program stipulates average weighted tariffs of no more than 20 per cent by the region's more developed countries-India, Pakistan and Sri Lanka – within two years of the entry into force of the agreement. Within five years after the completion of the first phase, India and Pakistan will adjust their tariffs to the 0-5 percent range. The region's least developed countries - Bangladesh, Bhutan, Maldives and Nepal-are required to have average weighted tariffs of no more than 30 per cent within two years, but would be allowed longer periods for the second downward adjustment: Sri Lanka in six years and Bangladesh, Bhutan, Maldives and Nepal in eight years. India, Pakistan and Sri Lanka will reduce their tariffs to the agreed low levels on imports from other countries no later than January 1, 2009.

The agreement also calls for eliminating quantitative restrictions (QRs) for products on the tariff liberalization list. No timeframe or mechanism has however been specified.

While member states have been allowed to develop list of sensitive items that would not be subjected fully to the stipulated tariff cuts, the number of products would be subject to review every four years.

The SAFTA agreement provides for the creation of two institutions to oversee implementation. The SAFTA Ministerial Council will be the highest decision making body and will consist of the ministers of trade and commerce of member states. The Committee of Experts, consisting of senior economic officials from each member state will support the council, report on implementation status semi-annually and serve as the dispute settlement body.

As regards SAPTA, Article 22 of SAFTA states that once the trade liberalization process is completed SAFTA shall super-cede SAPTA. Till then, all concessions granted under SAPTA shall remain available to the contracting states⁷.

If successful SAFTA Agreement will accelerate growth, deepen cross border trade and investment and lend political stability to the region. However to maximize the potential of the region in terms of intra-industry, efficiency seeking industrial relocation and the intra-regional trade the scope of the agreement needs to be enlarged to include the following aspects.

Investment Facilitation: The SAFTA treaty leaves out liberalization of investment in the region. This is a severe shortcoming given the possibilities of intra-industry trade and efficiency seeking industrial relocation in the region. The substantive point of a free trade area in South Asia is for small economies with narrow markets such

as Nepal, Bangladesh, and Sri Lanka to be able to use the incentive of the larger markets, particularly the Indian market to stimulate investment from within and outside the country.

Integration of Services in SAFTA: The SAFTA Treaty does not include provisions for the liberalization of trade in services. Services sector has acquired tremendous importance both in the GDP and exports of member countries. Services also figure prominently in the informal trade that is taking place in the region, particularly between India and other member countries. Some of the social services, particularly education and health, offer considerable scope for cooperation among the SAFTA member nations. These services are already being provided on a fairly substantial scale by some member countries to other member countries, through Mode 2 of service provision under GATS, that is, the movement of consumers for seeking services. This movement is generally one-way, particularly to India. Until now there are no generally agreed rules and regulations and procedures at the regional level, for providing services under Mode 2 and making things easier for the service seekers. The movement of people in the social sector can be facilitated by the gradual conclusion of MRAs on standards, qualifications and degrees and harmonization of standards.

Another service sector that offers immense scope is tourism. While there is already a degree of coordination among the member countries in this sector, it needs to be strengthened through both the joint development of tourist infrastructure and a well coordinated plan for promoting cross country tourism for specific purposes like pilgrimages etc

The SAFTA Agreement should in fact have considered ways and means to regularize and regulate trade in services in the region as inclusion of liberalization of services sector through SAFTA would have given an added impetus to intra-regional trade.

In addition to enlargement of scope of the agreement it is important for policymakers in South Asia to implement measures that are required to support the SAFTA process, even when these are not embodied in the Agreement itself. These are as follows.

Trade Facilitation Measures to facilitate trade and lower logistics costs are among the most important steps to promote intra-regional trade in South Asia. Inadequate trade facilitation mechanisms contribute to the unrealized trade potential between the SAARC member nations. A review of trade facilitation and transport

logistics in the region illustrates continued weakness of South Asian countries in port and transport infrastructure, regulatory environments and service – sector infrastructure. Delays at seaports due to congestion and outdated infrastructure, for example, raise costs for exporters throughout the region. The region can therefore gain by expanding intra-regional trade through complimentary investment in infrastructure and continuation of regulatory reform.

Regional transport network A well formulated plan in this context will link the region's road, rail and port systems and if broadly defined the infrastructure in the region should be developed also to link the electricity, gas and oil grids of the region.

Negotiate transit rights Of the seven SAARC member countries, two are landlocked, one, India shares border with four others, and two are island economies. The granting of transit rights for inter country commerce is essential and should therefore be depoliticized and not be conditioned by narrow country interests to facilitate free flow of commerce in the region.

Finally it is often said that the success of SAFTA is contingent upon India's trade policy and its ability to lead the region as has been the case for most successful regional trade arrangements like NAFTA, Mercusor etc that have had at their core a single large economy. Taking this a little further in this paper we propose that India can actually take the SAFTA/South Asia towards a full fledged Asia- wide FTA. The remainder of the paper explores this option for South Asia.

India-East Asia and an Asia-wide FTA

In an economically asymmetric South Asia India is the pre dominant economy. India has also in recent times emerged as one of the most dynamic economies in the world. Simultaneously, in East Asia ASEAN has initiated a phase of accelerated economic integration. In the post 1997-98 East Asian financial crisis ASEAN could actually use the fresh infusion of economic dynamism of India. As it is, trade trends reveal that India is increasingly getting linked with East Asia. In addition, the ASEAN economies are de facto integrated with the plus three economies of China, Japan and Korea through a market led process of integration. Further, an ASEAN+3+3 economic bloc that is inclusive of India has been envisioned on the lines of EU as part of the deliberations of Asian leaders at the December 2005 East Asia Summit. And last but certainly not the least the convergence of economic policies in Asia has led to a rethinking on the earlier strategic assumptions that influenced the emergence of particular regional groupings in

Asia. The new world order provides scope for redefining the territorial compass of the groupings of the future. Trade integration between India and East Asia is hence a practical possibility that we explore in this section of the paper. We suggest that once the dominant South Asian economy gets formally integrated with East Asia the other South Asian economies for whom India is the major trading partner may hasten their process of integration with India to gain access to the larger market. An accelerated SAFTA and an eventual South Asia-East Asia trade bloc may emerge. Following a brief profile of the economically asymmetric South Asia, the case for an India-East Asia trade bloc is examined below.

Economic Asymmetry in South Asia and the Pre- dominant Position of India

South Asia is economically asymmetric. India has a central position in South Asia. India is the largest economy with a GDP which is not just 80% of the South Asian GDP (2003) but also the 4th largest in the world (2004) in PPP terms. Over 75% of the region's population resides in India. The country has a GDP Per Capita that is second only to Sri-Lanka, and that too only on account of the latter's smaller population size. With a PCY (current) of 546\$ as against the South Asian average (excluding India) of 462 US\$ and a burgeoning middle class, the size of which has increased from 14% (113 mn.) in 1992-93 to 26% (250 mn.) in 1998-99, India provides a huge market for the region.

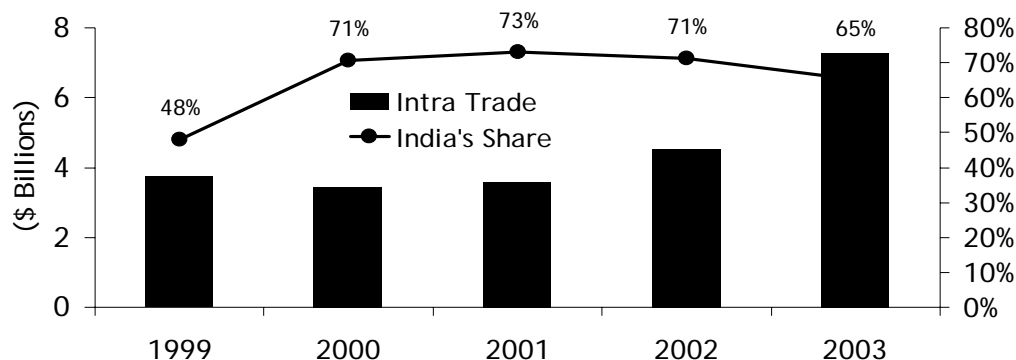
Table 2: Economic Profile of South Asia

Country	GDP (US \$ bill.)	GDP (PPP)	Rog of GDP	GDP PC (PPP)	Pop.(mn)
Bangladesh	51.9	244.4	5.3	1770.2	138.1
Bhutan	0.7	-	6.7		0.9
India	600.6	3078.0	8.6	2891.8	1064.4
Maldives	0.7	-	9.2		0.3
Nepal	5.9	35.0	3.1	1419.9	24.7
Pakistan	82.3	311.3	5.1	2096.9	148.4
Sri-Lanka	18.2	72.7	5.9	3777.8	19.2

Source: WDI, 2005.

As the only country that shares its land border with all the other South Asian countries, India accounts for 65% of intra - regional trade in South Asia (2003).

Fig. 2: India's Share in Intra South Asian Trade



Furthermore India is the major trading partner for most South Asian countries – the top for Bhutan and Nepal and is among the top 20 for Sri-Lanka, Maldives and Bangladesh. India already has bilateral trade treaties with three South Asian countries - Sri-Lanka, Nepal, Bhutan and negotiations are on with Bangladesh. India is a member of all regional/sub-regional groupings in South Asia like the Bangkok Agreement, the South Asia Growth Quadrangle etc.

India's Growth Story

Over the last decade and a half India has attained the identity of a dynamic economy in pursuit of a high rate of economic growth through the process of liberalization and economic reform. The Indian economy has grown at an average rate of 5.8 per cent during the 1980s and at 6 per cent during the 1990s and early years of this decade. India recorded the second highest average growth rate of 6.06 per cent per annum during 1992 - 2001 after China.

The growth process in India has been accompanied by macroeconomic stability. The coefficient of variation (CV, Refer Table 3 below) in the rate of growth of GDP in India has fallen from .40 in 1981-1991 to .25 during 1992-2005 which is lower than that for other ASEAN member countries like Indonesia (CV = 1.27), Philippines (CV = .56), Thailand etc. The exchange rate in India has also moved within a narrow range. Stability in exchange rate is evident from the coefficient of variation that was .33 in the pre - reform period and has since fallen to .19 in the post - reform period. Further, the inflationary forces in India have been under control and in fact, inflation has been maintained at single digit levels almost throughout the period of reform and more recently despite the rise in global oil prices. The stability in the pattern of growth

observed in India over the last decade is in contrast with the growth fluctuations experienced by East Asia and South East Asia.

Table 3: Coefficient of Variation (CV)

Country	Exchange Rate		Growth Rate	
	1980-1991	1992-2005	1980-1991	1992-2005
India	0.33	0.19	0.40	0.25
Indonesia	0.40	0.58	0.37	1.27
Japan	0.26	0.09	0.33	-
Korea	0.11	0.21	0.46	-
Malaysia	0.08	0.19	0.52	0.78
Philippines	0.40	0.32	2.50	0.56
Singapore	0.07	0.08	0.49	-
Thailand	0.08	0.23	0.40	1.15
Vietnam	-	0.34	0.32	0.17

Source: IFS, IMF 2001 and WDI, World Bank 2004

Further, India's growth process is regarded as more sustainable relative to other emerging economies of the region. Growth in India is an outcome of a protracted process of liberalization and economic reform. Domestic private consumption has been the primary driving force for the growth process. As such therefore, the fear of overheating, as is the case of export - led growth processes adopted in many other countries of the region does not hold for India.

The Economic Rationale for India - East Asia Trade Bloc

For the purpose of the analysis in this section East Asia is defined as inclusive of the ASEAN 10, China, Japan and Korea i.e. the ASEAN+3. As the first part of our proposal for an India-East Asia trade bloc i.e. ASEAN+3+1/ ASEAN+4, evidence in support of India's increasing trade linkages with the proposed bloc is presented.

Rate of growth of total trade with ASEAN+4

The average annual rate of growth of India's total trade with ASEAN+4 over 1999 – 2003 is 9.5 per cent. It is observed from Table 4 that this is close to the rate registered by China and greater than that for Japan and Korea over the same period. In 2001-2003 India has registered the highest annual rate of growth of total trade with the proposed

bloc in comparison with the plus three economies that are considered as already integrated with ASEAN⁸.

Table 4: Rate of Growth of Total Trade with ASEAN+4 (%)

Year	India	China	Japan	Korea Rep.
1999/2000	-3.2	33.0	28.3	31.2
2000/2001	11.4	5.4	-9.5	-11.8
2001/2002	24.8	21.9	5.3	13.2
2002/2003	37.3	37.4	20.6	23.8
Average annual rate of growth	9.5	12.7	3.0	5.3

Trade with ASEAN+4 vis a vis other regional blocs

India's trade with regional blocs presents an interesting picture (Table 5). In 1995 EU (15/25) was the most significant trading bloc for India in terms of its share in total trade. Trade with the EU constituted 28% of India's total trade. This was followed by NAFTA at around 15% and ASEAN at 8%. In 2003, the share of EU in India's total trade has fallen to 21% and the share of the proposed ASEAN+4 bloc has increased to about 20%⁹. With its share in India's total trade having increased to equal that of EU, ASEAN+4 has emerged as the other dominant partner bloc for India.

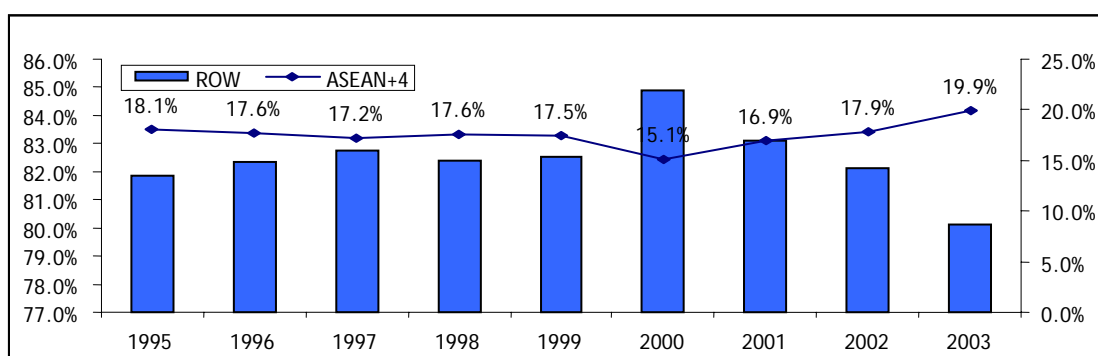
Table 5: Shares of Select Trade Blocs in India's Total Trade (%)

Year	EU15	EU25	NAFTA	Mercosur	ASEAN	ASEAN+4	SAARC
1995	27.4	28.0	14.9	0.8	7.8	18.1	2.9
1999	23.5	24.0	15.2	1.1	8.5	17.5	2.1
2003	20.2	20.7	12.9	0.9	9.3	19.9	3.4

Trade with ASEAN+4 vis a vis Rest of the World

India's trade orientation towards the proposed trade bloc is also apparent when we look at the increasing divergence between the shares of ASEAN+4 and rest of the world (ROW) in India's total trade. As is evident from Figure 3, there is a clear increase in the share of ASEAN+4 in India's total trade at the expense of the rest of the world (ROW). Over the period 2000 – 2003 the share of ASEAN+4 in India's total trade has increased from 15 to almost 20% and that of ROW has registered a fall from 85% to 80%.

Figure 3: Share of ASEAN+4 vs. ROW in India's Total Trade



As concerns individual member nations, three of the ASEAN+4 countries – China, Japan and Singapore feature among the top ten trading partners for India in 2003. Singapore and China first emerged among the top ten trading partners for India in 2000 and have remained so since then. China has over the same period emerged as the third largest trading partner for India.

India as a market for the ASEAN+4

Simultaneous with the increase in the share of ASEAN+4 in India's total trade it is observed that there is an increase in India's relevance for the ASEAN+4 nations. Evidence shows that India is increasingly being looked at as a market for exports (Table 6). Over 1995-2003 India registered the highest rate of growth in the region for Chinese and Indonesian exports. India is second only to China as the most attractive market in the region for Korean, Malaysian and Thai exports.

Table 6: India as a Market for ASEAN+4: A Comparison with the +3 Economies

Markets↓	Bru. Dar.	China	India	Indon.	Japan	R.O.K	Malay.	Phili.	Singap.	Thai.
CHINA	-	-	86.7	13.1	17.9	31.6	27.6	-	29.7	27.5
INDIA	-	37.4	-	39.7	-0.6	17.0	22.8	-	7.2	13.5
JAPAN	-	12.1	-2.6	1.2	-	6.1	2.2	-	0.6	2.3
ROK	-	22.3	7.7	5.4	1.3		5.3		9.6	11.0

Notes: figures in the table represent average annual rog of exports to the specific markets over 1999-2003

The fact that India is emerging as an important market for intra-regional exports is corroborated when we look at India's trade with ASEAN+4. It may be seen from

Table 7 that the average annual rate of growth of imports of India from ASEAN+4 exceeds the rate of growth of India's exports to ASEAN+4. In addition, when compared with the plus three economies, the rate of growth of India's imports from ASEAN+4 is second to China and significantly higher than that of Japan and Korea.

Table 7: ROG of Exports and Imports of the Plus Four Economies: 1995-2003

	India	China	Japan	Korea Rep
Imports from ASEAN+4	10.8	14.6	4.4	4.8
Exports to ASEAN+4	7.7	10.5	1.7	5.8

Having thus presented the case for India's inclusion in an ASEAN+4 trade bloc we proceed to establish the economic strength of the proposed bloc.

The proposed ASEAN +3+1/ ASEAN+4 region comprising two of the most dynamic economies in the world i.e. India and China has been referred to as the 'Arc of Advantage'. As may be noticed from the available facts presented in Table 8, the Gross National Income of the countries comprising this regional bloc is over US \$ 7.6 trillion in 2003 and is comparable to the US \$ 9.4 trillion gross national income of the European Union (EU). In terms of purchasing power parity, the national income of ASEAN+4 is US \$ 16 trillion and is more than the national income of NAFTA which is US \$ 13 trillion or EU which is US \$ 11 trillion. The combined total reserves of this region are about US\$ 2 trillion, and are much larger than that of EU. Given that the proposed fourteen country singular economic entity of ASEAN+4 has a 19 per cent share in total world trade which is almost as much as that of NAFTA and contributes 21% of the global output and is in addition home to about half of the world's population, it has the potential to impact the global as well as the regional economies.

Table 8: ASEAN+3+1 region: descriptive statistics

	ASEAN+4	NAFTA	EU
GNI (trillion \$)	7.6	12.5	9.4
National income (trillion US \$)PPP	16	13	11
Population (billion)	3.03	0.42	0.45
Total reserves (trillion US \$)	1.6	0.25	0.52
Share of world trade (%)	19.22	20.27	38.8

Source: WDI, World Bank, 2005

As evident from Table 9 the trends in intra bloc trade are encouraging. Intra-bloc trade as a per cent of total trade at an aggregate level for the ASEAN+4 economies along with some selected blocs is shown in Table 9¹⁰. Trade among the member nations of ASEAN+4 as against their trade with the rest of the world has registered an increase in the period 1995-2003 even though there was a fall in 1999, possibly on account of the East Asian crisis. In 2003 intra bloc trade for ASEAN+4 was 44%. This value of intra-regional trade share is higher than the corresponding share for many of the existing trade blocs in the year of their formation. For example, intra bloc trade for NAFTA was 42% in 1991 and for Mercusor it was 13% in 1991¹¹.

Table 9: Intra-Bloc Trade (%)

Regions	1995	1999	2003
ASEAN	25.5	24.6	25.3
ASEAN+4	42.0	39.5	44.0
NAFTA	45.0	50.1	49.9

It is also evident from Table 9 that the potential of ASEAN+4 for regional economic integration is higher than that of the existing regional bloc in Asia i.e. ASEAN. Intra - ASEAN trade is less than that for ASEAN+4. This fact is further corroborated when the trends for intra-bloc exports and imports as shown in Tables 10 and 11 are analyzed. There exists a positive difference between the levels of intra-bloc exports and imports for the proposed ASEAN+4 grouping as against the existing ASEAN. In 2003 intra-ASEAN trade – both exports and imports stands at 22% and this is much lower than the 35% and 43% of intra-ASEAN+4 exports and imports respectively.

Table 10: Intra Bloc Exports (%)

Year	1995	1999	2003
ASEAN	25.5	22.5	22.4
ASEAN+4	35.2	31.1	35.0

Table 11: Intra Bloc Imports (%)

Year	1995	1999	2003
ASEAN	17.5	21.8	22.0
ASEAN+4	38.9	39.8	43.0

The strength of the ASEAN+4 as a regional trade bloc may also be inferred from the degree of ‘trade bias’ among member nations evaluated using the index of trade intensity (TI). Table 12 below summarizes the change in the TI index at 3 time points and for a comparative picture the TI indices at the same time points are also shown for NAFTA. The TI index for ASEAN+4 clearly documents the increase in the concentration of trade within the region. The TI index as shown in Table 12 exceeds unity. This is indicative of “intense” trade relations within the ASEAN+4 regional grouping. The TI index for ASEAN+4 is comparable to that for NAFTA, particularly at the time of the latter’s coming into effect¹².

Table 12: Intra-regional Trade Intensity Index

Regions	1995	1999	2003
ASEAN	3.9	4.5	4.4
ASEAN+4	2.1	2.2	2.2
NAFTA	2.4	2.3	2.7

India-East Asia-and the efficiency of the ASEAN+1 route

In this section an attempt is made to determine if India’s entry in the proposed regional bloc implies any efficiency costs by way of distortion in the patterns of trade away from those expected on the basis of India’s global comparative advantage and hence vis a vis the multilateral liberalization process.

Efficiency costs are estimated by undertaking a comparison of India’s comparative advantage in the regional market and the world market. Alignment of the structure of a country’s comparative advantage in the two markets will imply fewer shifts in the production structure and lower costs as a consequence of an FTA with ASEAN. In addition we have also compared the revealed comparative advantage (RCA) cross classified by factor intensity. The analysis will provide evidence of a shift, if any, of the factors of production, between industries that may be required as a consequence of regional integration. Alignment of comparative advantage has been analyzed for two

possible routes of India's entry in the regional bloc: a) in the ASEAN+1 framework as do other plus three economies –a convergence of the plus one initiatives will lead to an ASEAN+4 trade bloc; and b) India enters last through an ASEAN+1 framework in an already integrated trade bloc of ASEAN+3. Results for these two alternatives are presented in Tables 13 and 14¹³.

Table 13: Alignment of Comparative Advantage vis a vis Multilateral Liberalization

	India	China	Japan	Korea Rep.
All Sectors	0.66	0.72	0.73	0.63
	<i>0.73</i>	<u>0.84</u>	<i>0.79</i>	<i>0.78</i>
Agriculture & Allied	0.63	0.60	0.59	0.55
	<i>0.74</i>	<u>0.81</u>	<i>0.67</i>	<i>0.74</i>
Manufacturing	0.67	0.74	0.72	0.63
	<i>0.73</i>	<u>0.85</u>	<i>0.78</i>	<i>0.78</i>
Minerals & Mineral Fuels	0.64	0.44	0.68	0.48
	<i>0.82</i>	<u>0.85</u>	<u>0.89</u>	<i>0.78</i>
Chemicals & Plastics	0.70	0.75	0.65	0.67
	<i>0.75</i>	<u>0.86</u>	<i>0.73</i>	<u>0.82</u>
Manufacturers chiefly by Mat.	0.69	0.74	0.71	0.61
	<i>0.74</i>	<u>0.83</u>	<i>0.79</i>	<i>0.77</i>
Machinery	0.55	0.72	0.76	0.65
	<i>0.57</i>	0.82	<u>0.84</u>	<i>0.79</i>
Misc (HS 90-99)	0.38	<u>0.85</u>	0.73	0.60
	0.50	<u>0.85</u>	<u>0.82</u>	<i>0.75</i>

Note: Italicized: ASEAN+4; Bold: Moderate; underlined: high; All others: Low; All significant

Table 14: Alignment of Comparative Advantage and Shifts in Factor Intensity

	India	China	Japan	Korea Rep.
Human-Capital Intensive	0.71	74	0.72	0.65
	<i>0.75</i>	<u>0.82</u>	<i>0.79</i>	<i>0.78</i>
Primary	0.65	0.55	0.62	0.57
	<i>0.77</i>	<u>0.82</u>	<i>0.77</i>	<i>0.79</i>
Unskilled-Labour Intensive	0.62	0.66	0.71	0.60
	<i>0.68</i>	<i>0.75</i>	<i>0.78</i>	<i>0.75</i>
Natural-Resource Intensive	0.71	0.62	0.75	0.60
	<i>0.75</i>	<i>0.77</i>	<u>0.80</u>	<i>0.77</i>
Technology Intensive	0.64	0.72	0.71	0.66
	<i>0.67</i>	<u>0.85</u>	<i>0.79</i>	<u>0.81</u>

Note: Italicized: ASEAN+4; Bold: Moderate; underlined: high All others: Low.;

As against multilateral liberalization, participation in ASEAN does not imply significant shifts in the comparative advantage and consequently in the production structure. We observe a broad alignment of comparative advantage in terms of factor intensity for the plus four economies in the world and regional markets. India's entry in an ASEAN+4 bloc is therefore efficient and does not imply any major additional costs over and above participation in the multilateral process of liberalization.

India and East Asia is thus a potentially feasible trade bloc and the ASEAN+1 an efficient route towards achieving this. The process of ASEAN-India negotiations is already under way. For the South Asian economies for which India is the predominant trade partner, this should lead to an acceleration in their pace of integration with India as this will give them a direct and easy access to the 'Arc of Advantage'.

It may in the meanwhile also be useful to explore two existing agreements that have the potential to give a concrete shape to the South Asia – East Asia trade bloc particularly given the economic advantage of an Asian bloc that spreads across sub-regions of South and East Asia. These agreements are the BIMSTEC and the Bangkok Agreement. A brief description of the Agreements is given below.

BIMSTEC: At the sub-regional level, the major initiative is BIMSTEC. BIMSTEC comprises Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan and Nepal. This initiative includes countries from both SAARC and ASEAN and in fact acts as a bridge between the two. The first ever summit - level meeting for BIMSTEC was

held in July 2004 when it acquired its new incarnation - the Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation. This Bay of Bengal initiative is dynamic and offers the prospect of widening the network for outward oriented growth in this part of Asia. It can emerge as a bridge between the more inward oriented South Asia, and the more outward oriented South East and East Asia. Through this route India, followed by SAARC can reach out to the South East Asian region and beyond to the Asia-Pacific community. The BIMSTEC Draft FTA Agreement provides for inter alia a two track tariff reduction/elimination programme, liberalization of trade in services, investment and cooperation in identified sectors of technology, transportation and communication, energy, tourism and fisheries¹⁴. The timeline for negotiations for tariff reduction and investment and services has been pre-specified. The BIMSTEC Agreement therefore holds prospects for a much larger Pan-Asian economic cooperation in the long run.

Bangkok Agreement: Bangkok Agreement was signed in 1975. Members are Bangladesh, China, India, Republic of Korea, Laos and Sri Lanka. The Agreement is at present limited in scope as it covers only tariff concessions on goods. The Agreement has been revitalized in 2001 with the entry of China. This agreement is a more potent instrument than the BIMSTEC as a facilitator for South Asia – East Asia economic integration. That China, India and Republic of Korea are already members of this agreement is indicative of the huge market potential inherent in the agreement. Further, the agreement is open to all developing member countries of ESCAP and is consequently the only truly regional trade agreement in Asia. In terms of its potential membership this is the only agreement that has the potential to develop into a regional trade agreement leading to regional economic integration in Asia.

To be more useful for the purpose of regional integration both the Agreements call for a review of scope – both in terms of member nations and sectoral coverage. It may be an even better idea to work on these two aspects of the Agreements while simultaneously considering the merger of BIMSTEC and the Bangkok Agreement. Ultimately it needs to be realized that an Asian bloc will not just benefit the region and its economies as analyzed above¹⁵ but can be a potential instrument of changing incentives for the trade blocs in the Americas and Europe and actually make possible multilateral freeing of trade.

Notes

¹ South Asian Association of Regional Cooperation.

² Some studies have shown the number to be around 4%. Taking the variation in estimates in intra regional trade for South Asia across different studies - it can still be said that intra-regional trade as percentage of total regional trade is less than 5%.

³ A series of earlier papers like Wonnacott, Paul and Mark Lutz (1989), Summers, Lawrence (1991), Krugman (1993) and Frankel et al (1995). Member nations of RTAs with high initial trade volume are referred to as 'natural trading partners'.

⁴ The more robust indicator for intra-regional trade bias like the index of trade intensity (TI) is also very low for the region. However, TI index for bilateral relationships reveals a positive trend for India and Nepal, Bangladesh and Sri Lanka indicating the region's intense and increasing dependence on India as a trade partner. In case of other bilateral relationships the trend is observed to be asymmetric over the 1990s.

⁵ Global Economic Prospects, 2004 World Bank.

⁶ India- Sri Lanka FTA has been a landmark bilateral free trade agreement in South Asia. The agreement came into effect in 2000. It has boosted bilateral trade between the two countries. The Agreement led to reducing Sri-Lanka's trade deficit with India from 11:1 in 1999 to 5:1 in 2002. Sri Lankan exports to India accounted for 3.6 per cent of overall exports in 2002 in comparison to 1999, when Sri Lankan exports to India accounted for one per cent of overall exports. India has become the 5th largest destination for Sri Lankan exports in 2002 compared to the rank in 20s in the mid 1990s. India is the largest source of imports for Sri Lanka and accounts for 14 per cent of overall imports. Also Sri Lanka has, as a consequence of the FTA become the hot destination for FDI as many countries now see it as door of opportunity to access the huge Indian market. Indo Sri Lanka bilateral FTA has now graduated to an India-Sri Lanka CEPA where liberalization of services, more flexible RoO and shorter sensitive lists are to be included.

⁷ The question of an overlap between SAFTA and SAPTA therefore will not arise.

⁸ While India's linkages are growing at the highest rate, the share of the proposed bloc in total trade of the plus three economies is double that of India's and trade intensity is consistently above unity, indicating thus existing 'intense' trade relations between ASEAN and the plus three economies. (Batra, 2006)

⁹ It may be noted that the share of ASEAN in India's total trade has remained at about the same level over 1995-2003.

¹⁰ Data has been presented at four year intervals to reduce the influence of any annual irregular variations such as those on account of fluctuations in commodity prices.

¹¹ Maurice Schiff & L. Alan Winters (2003).

¹² This corroborates earlier evidence in favor of the ASEAN+4. Intra-regional trade shares for ASEAN+4 in contrast with that of ASEAN are comparable to that for NAFTA at the time of the latter's formation.

¹³ This part of the analysis draws from Batra (2006).

¹⁴ Economic cooperation in 6 sectors with designated lead countries: Bangladesh: trade and investment, Sri-Lanka: technology, India: transport and communication, tourism, Myanmar: energy, Thailand: fisheries

¹⁵ This Asia wide FTA will have many efficient and competitive countries thereby minimizing the extent of trade diversion relative to SAFTA.

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