SHIFTING PARADIGM OF REGIONAL INTEGRATION IN ASIA

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1. Introduction

The objective of this paper is to examine the prospects for and progress in economic interdependence and regional integration in Asia. In particular it focuses on the changing scenario in integration of South Asia into the rest of dynamic East and Southeast Asia. With India emerging as a rapidly growing economy and with enhanced interest in sub-regional and regional integration taken by the South Asian economies, novel intra-regional economic ties have been evolving.

During the last millennium, different geographic Asian economic regions had fairly good economic relations, albeit they were not economically integrated in the modern economic meaning of the term. Smooth trade flows and active commercial activity led to prosperity in many parts of Asia. Historical evidence is available to show that the Eastern, Southeastern and Southern regions of Asia continually interacted economically with each other and a good deal of commercial activity existed among them for centuries. To be sure, there were periods when this mutually profitable commercial interaction broke down and periods of hiatus and those of isolation of specific economies followed. Integration of Asian economies, particularly those from the South, East and Southeast Asia is neither a novel concept nor a new phenomenon. If the various sub-groups or sub-regions of Asian economies are now attempting to integrate, they are trying to return to their past.

The concept of regionalism was slow to be adopted by the public policy makers in Asia, albeit regionalization came naturally and swiftly to the Asian economies of the East and Southeast Asia. South Asian economies were the last as well as slow to espouse regionalism. During the post-World War II era, the South Asian economies were not only regarded as the slow-growth economies of Asia, but they were also late starters in integrating among themselves and with the rest of the dynamic sub-groups of Asian economies. During the decade of the 1990s they took initiative in integrating among themselves as well as with the other dynamic Asian economies of the East and Southeast. This article focuses on the on-going process of regional integration. The Association of South East Asian Nations (ASEAN)[1] is emerging as the locus of this integration process. Both China and India could play a meaningful role in the integration of South Asia in the rest of Asia and they did. One method of integrating South Asia with the rest of Asia is to integrate the relevant sub-regions. This integration process is in its preliminary phase and

[1] The six original members of the Association of South East Asian Nations (ASEAN) are: Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand. The four members that joined later were Vietnam in 1995, Laos and Myanmar in 1998 and Cambodia in 1999.

advancing. If anything, it picked up momentum in the early years of this century. A large number of small agreements that took place over the 2000-2005 period are also integrating the Asian economies of different sub-regions, which includes South Asia.

2. Is the Past Prelude to the Future?

Recent historical researchers have documented international trade between Asian economies and between Asian and European economies during the thirteenth and fourteenth centuries (Abu-Lughod, 1989; Frank, 1998). Smooth trade flows were well established and stretched over countries of South, East and Southeast Asia as well as between northwestern Europe and Asia. A network of manufacturers, producers and merchants existed, that produced and exchanged an impressive array of goods and commodities. During the first half of the last millennium, there was thriving intra-Asian and Asia-Europe trade in commodities that had high value and low volume, although little trans-border financial flows. Both People's Republic of China (hereinafter China) and India had emerged as countries with relatively large populations and had significant trade links and trade volumes. It was an extensive trader. It engaged in trade with Southeast and South Asia the Islamic world of central Asia and the Middle East and North Africa, the Mediterranean countries and Europe. This trade utilized both the fabled Silk Road and ocean routes. In an identical manner India traded with the Southeast Asian economies, the Islamic world through the ocean routes and the Mediterranean and European countries through both land and ocean routes.[2] During this period, with the exception of the advanced Italian city-states and Flanders, Western Europe was essentially a sprawling agrarian area (Findlay, 1996; Findlay and O'Rourke, 2001).

During the thirteenth century the Mongol Empire had established itself. Thereafter, the Pax Mongolica unified Asia—and also linked it with Europe—leading to the genesis of a global economy. China, India and the Islamic world became large traders of commodities from their own respective regions and other parts of the erstwhile global economy. It was a dynamic scenario, and a complex pattern of trade linkages continually evolved. With it not only trade in commodities was promoted through the land routes but also transmission of ideas, techniques and migration of labor took place (Needham, 1954, Das, 2004a).

Over the first half of the second millennium, Northeast Asia not only had succeeded in creating a vigorous economic system in its own right but also had trade and financial links with the other parts of Asia. [3] In the second half, two core sub-regions of economic activity emerged. During this

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[2] See Das (2004a).

[3] Marco Polo (1254-1324) was the most famous European traveler of the Silk Road. He excelled all the other travelers of this period in his determination, writing, and influence. His journey through Asia lasted 24 years. He reached further than any of his predecessors, beyond Mongolia

period, the so-called "industrious revolution" took place in Asia. Between the 15th and 18th centuries these two sub-regions, namely, China and India formed two "gigantic world economies" served by a maritime force controlling the seas. The third such economic sub-region in the West was the Islamic world. A nautical force serviced the Pacific Rim and Indian Ocean rim economies. However, Braudel (1984) flashed an amber signal and alerted that the economic interaction between these three sub-regions was far from continuous. In his view, it could be best described as "intermittent". Also, economic activities sometimes benefited the East, while on other occasions benefited the West, affecting functions, division of labor and economic powers in the three sub-regions. During periods when economic interactions ceased completely between the three sub-regions, Asian economy was left splintered into "autonomous fragments" (Braudel, 1984).

Indeed, there were periods when some areas turned to autarky, like China in the mid-15th century and Japan in the 17th century. But even during ostensibly autarkic periods when these economies eschewed trade and closed the outsiders off, evidence is available to show that they were far from completely isolated. With the help of the economic historic literature cited above one can create a realistic scenario of an evolving global economy, trade and financial flows in it, and development of institutional and systemic structures. As regards the technological developments, Asia's strength in shipbuilding, printing, textiles, metallurgy, and transport are well documented by Frank (1998). That different sub-regions constantly interacted economically and Asia had a significant place in the world system throughout this period is clearly brought home by this relatively recent literature.

Founding of Manila in 1571 as a large port and trading center is considered by many as the beginning of truly global or inter-regional trade. The deep water port and the city around it developed and functioned as an active *entrepot*, which facilitated trade between different sub-regions of Asia as much as between different regions of the global economy of that period (Flynn and Giraldez, 1995). Its value as a center for trade in unifying the different sub-regions of Asia remained high until the beginning of the nineteenth century. It contributed significantly to the regional development process, which is not to mean that its value in promoting trade with other regions of the global economy was low.

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to China. He became a confidant of Kublai Khan. He traveled the whole of China and returned to tell the tale, which became the greatest travelogue. Interestingly, writing was not his forte. The accounts of his life in the court of Khubilai Khan and those of his voyages were not written by him but by a small time novelist who was imprisoned in Genoa with Marco Polo in the same dungeon, when a war broke out between Genoa and Venice.

To be sure, over the centuries spatially Asia has undergone considerable transformations, and many of the cities, territories, and regions have changed beyond recognition, but the contribution various Asian centers of trade as well as that of Asia as a region to the global economy cannot be denied. Recent researchers have uncovered that during several sub-periods of history the region worked as an integrated economic system and a leading participant in the global economy, making its mark on it. Until 1800, Asia was the epicenter of the global economy (Maddison, 2000). Sakakibara and Yamakawa (2003) inferred that notwithstanding the impermanent and intermittent nature of the flow of economic activity, for long periods period Asia played an "instrumental role in the global division of labor and its conduct in the world economy was open and outreaching."

3. What is Regional Integration?

If multilateralism is a complex metaprocess, regionalism is only more so. It is an economic process inextricably linked to political objectives and cultural backdrop of the integrating countries. Institutionalized regionalism and market-led regionalization are a part of the taxonomy of regional integration. They are two different, albeit parallel, phenomena. The former is a government-led, institutionalized, top-down process of bringing together of economies of a region or sub-region, with agreed and declared economic objectives and channels of regional integration. It starts with the prescribed modes of limited economic liberalization between the members. As opposed to this, regionalization implies market-driven, profit-motivated, increase in economic interaction and interdependence that occurs through expansion of trade, investment, technology and migration flows. It is a bottom-up process, driven by the initiative of private sector, and is bereft of any officially laid down framework of co-operation. The dominant driving force behind regionalization is the profit-maximizing behavior of business firms and corporations.

Microeconomic decision-making in large firms, particularly transnational corporations (TNCs) played an active role in the spread of regionalization in the East and Southeast Asian economies. They have been the foremost source of global foreign direct investment (FDI). Indicators like sales, assets, gross value-added, employment, and exports of TNCs and their subsidiaries show that the role of FDI and TNCs in the global economy has continued to grow monotonically (UNCTAD, 2004). In 2004, 61,000 TNCs and 900,000 foreign affiliates were carrying on their operations globally. Since 2002, their role in the global economy has gained further momentum.[4] Little wonder they are regarded as a domineering basis of regionalization and globalization.

Regionalization implies economic integration across national boundaries, but in a macro-region of markets for goods, services, labor and knowledge. It occurred in the East and the Southeast

[4] See UNCTAD (2004) Chapter 1, Table 1.3 and Figure 1.6.

Asian economies. The South Asian economies were precluded from this process until recently. Business firms, corporations and TNCs *inter alia* influence the process of regionalization by lobbying their governments for facilitating regulatory changes, so that market forces can be freed to operate in the macro-region. Although little theoretical research is available on this subject, regionalization is a macroeconomic phenomenon based on microeconomic decisions.

3.1 Differentiating Regional Integration in Asia

Institutionalized regionalism was slow to lay down its roots in Asia, if anything it was much slower in South Asia. This sub-group of Asian economies was apathetic and ambivalent and did not show any interest in regionalism until recently. The Asian growth paradigm has the distinct characteristic of "going without regionalism". Relative to other regions of the global economy, East and Southeast Asian economies were slow to move towards the concept and phenomenon of regionalism, and espoused institutionalized regionalism much later than the other regions. One reason why policy mandarins in the East and Southeast Asia ignored the concept was that market-driven regionalization had spontaneously and logically supplanted it (see Section 3.2 below).

This strategic stance was in stark contrast to other parts of the global economy, in particular Western Europe and Latin America, where regionalism burgeoned early during the post-World War II era. Time-honored aloofness of the Asia from the trend of creating regional integration agreements (RIAs) testifies to this fact. The term used by the World Trade Organization (WTO) is regional trading agreement (RTA) not regional integration agreement (RIA) and is defined as the result of "actions by governments to liberalize or facilitate trade on a regional basis" as against multilaterally.[5] The core principle of an RTA is abrogation of the fundamental most-favored-nation (MFN) clause of the WTO and provision of preferential treatment to the RTA partners, which is permissible under Article XXIV of the WTO (Das, 2004b). Unlike Asia, throughout the pos-War period Western Europe and Latin America notified a large number of RTAs to the GATT/WTO system.

Gravity model confirms that geography matters, which implies that there is a theoretical case for Asian integration, as well as that of South Asian integration with the rest of Asia. If other factors are held constant, trade intensities between any pair of countries decline by approximately 10 percent for each 10 percent increase in distance between them, or their economic centers (Helliwell, 2000; Frankel and Rose, 2000). Although South Asian economies do not share common borders with many of the other Asian economies, these countries are geographically

[5] Refer to the WTO publication "WTO: Scope of RTAs", available on the Internet at www.wto.org/tratop/region/regrul/ September 2003.

close together. Therefore, South Asian economies should be able to significantly increase their trade with the rest of Asia by eliminating trade barriers—like tariffs and non-tariff barriers (NTBs)—and harmonizing regulatory policies.

3.2. Market-Driven Profit-Motivated Economic Integration

Post-War growth and industrialization in South Asia on the one hand and East and the Southeast Asia on the other took place in characteristically different manner. Their growth strategies were polar opposite of each other. While the former pursued import-substituting industrialization (ISI), the latter sub-regions epitomized the success of outer-orientated growth and industrialization strategy. The ISI strategy was among the reasons behind tepid post-War economic growth performance of the South Asian economies. This sub-group of Asian economies lagged way behind the so-called "miracle" economies of East and Southeast Asia.

The differing growth strategies and patterns also influenced regional integration paradigms in the sub-regions. When rapid economic growth occurs in any region or sub-region, it develops and strengthens economic ties between adjacent economies, *a fortiori* when this growth process is a function of outer-oriented growth strategy. These ties are strengthened through the development of business ties of enterprising profit-seeking firms across the political boundaries. Therefore, market forces and microeconomic decision-making play a dominant role in regionalization. This genre of economic integration is parallel to globalization. Competitive firm activity is at the foundation of market-driven integration. These were the characteristics of regional integration in the East and subsequently Southeast Asia. The knowledge-intensive industries are characterized by intense competitive pressure, which is focused on prices and product differentiation fronts. Profit margins are continuously eroded by competitive forces. Speed-to-market is another important variable in the knowledge-based industries.

The market-driven regionalization process is supported by both, technological advancement and globalization. There are definitive economic incentives for large business firms and TNCs for locating their production process in locales which enable them to produce efficiently, at least cost. While East and subsequently Southeast Asian economies clairvoyantly benefited from these strategies, South Asia ignored it completely until recently. Contemporary technological progress and advances in the information and communication technology (ICT) have coalesced to make it feasible to locate production processes away from the headquarters and integrate and manage them efficiently. This gives business firms a global freedom of choice regarding the locales of their production networks. This trend has progressed *pari passu* with the freer global movement of capital and skills. As globalization moved forward, capital tended to move where the returns were the highest, while skills move to locations where it is highly valued (Das, 2005a).

An important direct consequence of this freedom of choice for business firms and the resulting trend in regionalization and globalization of production networks is that unattractive locales began suffering from industrial hollowing-out as well as brain drain. Conversely, policymakers came under pressure to create attractive, if not enticing, economic and financial environment for facilitating inward movement of capital and productive ingredients like skills and technology. An addition factor strengthening the same trend was the operation of supranational institutions like the International Monetary Fund (IMF), World Bank and the WTO, which endorsed and promoted liberalization of economies since the 1980s. To be sure, these dynamics were not unique to Asia. However, the Asian policy makers innovatively pieced together an economic and financial environment that promoted trade and FDI on the one hand and was found suitable for the creation of integrated production networks. Regional integration was a direct consequence of this policy framework (Das, 2004b).

As alluded to above, the high-performing economies of East and subsequently Southeast Asia had adopted outer-oriented strategies, they had methodically promoted openness to trade and foreign investment, albeit after a brief flirtation with ISI strategy, over the preceding four decades. A brisk market-led expansion in intra-regional trade and investment logically followed. Regionalization was a byproduct of the implementation of the outer-oriented development strategy by the regional economies. When this trend of market-led economic dynamics of the region strengthened, it became responsible for the development of regional production networks. Operations of large corporations, including TNCs, contributed to the growth of a pan-Asian industrialization and integrated production networks. The South Asian sub-group of economies did not participate in market-led economic dynamism.

A large body of research exists demonstrating that brisk trade and outward economic orientation were among the primary forces behind rapid economic growth in the high-performing economies of East and Southeast Asia, unlike South Asian economies. This literature is too well known to be discussed here. Several empirical studies have concluded that with rapid growth, the economic structure of Japan, the newly-industrialized Asian economies[6] (NIAEs), the ASEAN-4 economies,[7] and China underwent substantial structural transformation, which in turn had a direct bearing on factor endowments in individual economies. The outer-oriented strategy led not only to efficient resource allocation in these economies but also enabled them to exploit their comparative advantage in an efficacious manner. Growth, structural transformation and changing factor endowments naturally ushered in transformation in the manufacturing sector, which was

[6] Hong Kong SAR, Korea (Republic of), Singapore and Taiwan.
[7] Namely, Indonesia, Malaysia, the Philippines, and Thailand.

followed by that in the services sector. The Heckscher-Ohlin theory supports and provides an explanation for the resulting transformation in the comparative advantage of different Asian economies and/or country groups (Das, 1998). There were two notable characteristic of outer-oriented growth paradigm in Asia: First, these economies did not record high (or low) trade in relative and absolute terms only in certain product lines or sectors. Similarly, trade in these economies was not concentrated in only a few select sectors (Das, 2000a). Second, there was no characteristic Asian export path or Asian export route that was followed by the East and Southeast Asian economies. Few generalizations could be made in this regard for these two sub-regions. Individual economies chalked out their own export expansion route.

While Asian economies promoted regional trade and investment in an extensive, enthusiastic and functional manner, there were several reasons why the Asian economies spurned formalized regional cooperation. For one, the heterogeneity of the region is much higher than that in the other regions like Western Europe and Latin America. It discouraged launching of such institutionalized regional integration initiatives. Second, several neighboring economies did not have amicable historical and political relationship, while there were others that were even hostile to each other. Third, emphasis on nationalism in economic policies was another reason. Many economies were more focused on promoting their narrow national interests and specific industries than on underpinning the regional economic strengths. Fourth, due to their penchant for outward economic orientation the dynamic Asian high-performing (AHP) economies established liberalized trade and FDI policy regime early on in their growth endeavors, which ran counter to the doctrine of institutionalized regionalism.[8] Lastly, several Asian economies developed strong trade and investment bonds with the industrial economies, particularly the United States (US), during the post-War era, which in turn delayed the formation of formal regional groupings. Until the early 1990s, the US had a strong commitment to multilateralism and an ostensible aversion to regionalism.

3.3 Driving Forces of Belated Regionalism

During the post-War era, regional integration became a significant component of international economic order. However, aspirations of creating a pan-Asian economy were slow to surface. Although a second best strategy to multilateral liberalization, it has its benefits. Somewhat belatedly Asian policy mandarins realized the value of these benefits. They belatedly

[8] The founding member of the Asian high-performing (AHP) group was Japan. It was followed by the four "dragon" economies (Hong Kong, Korea, Singapore and Taiwan). Next group of economies to join the AHP was the four larger members of the Association of South East Asian Nations (ASEAN), namely, Indonesia, Malaysia, the Philippines and Thailand. China claimed its membership last, in the 1980s. India and Vietnam turned in better economic performance during the 1990s than in the past and seem to be the plausible future members of the AHP group.

acknowledged regional integration as a complementary strategy of economic growth and recognized the need to adopt it with an objective to expand trade and promote real GDP growth rate. Regional integration allows fuller benefits of increased openness to trade. It is being increasingly realized that regional development cooperation and integration is an effective policy instrument for locking in reforms and improving the investment climate. In addition, regional integration can be achieved in a shorter period than multilateral liberalization. Also, it is a means of prevailing over multilateral constraints to international trade liberalization, which is an onerous and time-consuming process. This strategy can help create a zone of enhanced economic efficiency. Regional integration can potentially be an important instrument of integration into the global economy. Eventually global economy gains in welfare terms from this new structural revolution. Salutary influence of regional integration works through two principal channels. They work through scale economies and enhanced competition in the integrated region as well as through trade expansion and location effects. A long-term forecast by Roland-Holst *et al* (2005), which used the new GTAP (version 6) data base[9] with a dynamic global model, indicated that regional integration can accelerate GDP growth rate of Asia, particularly for the low-income Asian economies.

Interest in institutionalized regional integration in Asia came about as a reaction to expanding regionalization in North America, Western Europe and Latin America. Asian economies sought to strengthen their negotiating leverage against these regional and sub-regional groupings. This is known as the counter-regionalism factor that motivated the Asian policy makers and they began conceiving RTAs and FTAs during the 1990s. However, it was the Asian crisis of 1997-98 that had a large impact over the mindset of Asian policy makers and was another more important motivating factor, which gave a substantial impetus to regional integration in the Asian economies (Munakata, 2002).

Following the Asian crisis, several large Asian economies began supporting the concept of regionalism and taking serious policy measures to regionally integrate. One reason was their "growing frustration with the unilateral approaches by the US and 'market fundamentalism' symbolized by the Washington Consensus" as well as dissatisfaction with the US dominated international organizations (Yap, 2005). Gross dissatisfaction of Asian countries with the handling of the crisis by the Bretton Woods institutions was never concealed (Das, 2000b). In the post-crisis period, Asian economies tried to promote an effective mechanism for regional cooperation based on geographic proximity and de facto integration. Proposals for reducing trade dependence on extra-regional markets and basing economic growth firmly on the regional

[9] Abbreviation GTAP stands for Global Trade Analysis project. For the details of the model see Hertel (1997).

demand were also made (Munakata, 2002). That belated regionalism is taking place in Asia and is gaining momentum is evident from the recent spate of RTAs and bilateral trade agreements (BTAs) since 2000.

3.4 Complementarities in the Modern Asian Economies

After following half a century of diverse as well as similar growth paths, in the initial years of the 21st century economies of East, Southeast and South Asia found themselves at dissimilar stages of economic development, having a great deal of complementarities. Secondly, substantial complementarities also arose from diversity in their factor endowments. By developing close inter-linkages, the regional economies could astutely exploit the complementarities among them for mutual benefit. For instance, if there are Asian economies that are capital surplus and can be the bankers of the region (like Hong Kong SAR, Singapore and Taiwan), there are those that suffer from severe savings gaps. Likewise, striking complementarities exist in technology, skilled manpower and resources. Some large industrial sectors in the region that face capacity underutilization can indeed benefit from the regional demand and can run to full capacity. Construction and engineering industries in Korea and Japan are known to run well below full capacity utilization, which causes significant loss of output (Chaturvedi *et al*, 2006). It is being increasingly realized in the public policy-making circles that such complementarities in resources, skills and industrial capacities need to be regionally exploited.

Regional trade agreements between East and South Asian economies were driven by the above-stated facts and strategic thinking. This realization is also encouraging regionalization of the South Asian economies and providing them an impetus for moving towards institutionalized pan-Asian regionalism. Such endeavors cannot succeed without political will as well as political energy of the potential member countries. Political commitment to regionalization endeavors has been on the rise. From time to time top political leaders in the region, including Dr. Manmohan Singh, Dr. Thaksin Shinawatra and Wen Jiabao, have made earnest public statement in support of regional integration. They have talked about pan-Asian dreams, shown nostalgia for the remote past and talked effusively about possibility of an Asian century.[10] They proposed initiation of Asian Cooperation Dialogue (ACD) and launching of an ambitious Asian Economic Community (AEC). The basic concept they dealt with was to make the arc of countries between Korea and Pakistan an economic region of unparalleled synergy in which resources, technology and factors of production can move freely for the mutual benefit of the cooperating economies. Several academic proposals of an overarching RTA, or some other form of regional economic

[10] See the public speech by the Chinese Premier Wen Jiabao delivered during the Second Session of the Tenth National People's Congress in Beijing. It was reported in the *People's Daily*, of March 14, 2004. His speech was entitled, "Promote a New Centennial Asian Cooperation with Common Efforts".

arrangement, comprising the same set of countries have been made.[11] The proponents felt that without a framework of regional integration trade, factors of production and resources cannot be developed and deployed to their optimal potential. Utilizing the RTA as the building block of larger regional integration was publicly supported by India, the Philippines and Singapore in the recent years.

Realization of significance of inter-linkages and the value of inter-dependence among the regional economies was behind the historic First East Asian Summit of December 2005, in Kuala Lumpur, Malaysia. It aimed at deepening integration and cooperation in the region in order to promote economic growth. The participating heads of state of state included ASEAN, Australia, China, India, Japan Korea and New Zealand. Priority was assigned to narrowing the development gap in the region, through technology transfer and infrastructure development and capacity building, good governance. Promoting financial links among the regional centers and expansion of intra-regional trade and investment were also regarded as imperious objectives calling for immediate attention from the regional governments.

4. India's Role in the Regional Integration of South Asia

The South Asian sub-region comprises seven economies, namely, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka, which are members of South Asian Association for Regional Cooperation (SAARC). Its charter was accepted by the members in 1985. Conflicts in the past among the SAARC members have made the process of coming to agreements and implementing them in an effective and efficacious manner a time-consuming and difficult one. SAARC often gave an impression of being a forum where the member countries carry on discussions and organize seminars and conferences, rather than thoughtfully devise pragmatic sub-regional economic policies for the common good of them all and implement them in a methodical manner so that their GDP growth can be accelerated.

India is by far the largest SAARC economy, while Pakistan and Bangladesh are the second and the third largest (Table 1). The size of the GNP and per capita income of these economies according to the latest available data are as follows:

Table 1

Gross National Income (GNI) in 2004

	GNI in Billions of dollars	GNI Per Capita In dollars

[11] See Wei (2004) and Yao (2005).

1. India	673.2	620
2. Pakistan	90.7	600
3. Bangladesh	61.3	440
4. Sri Lanka	19.5	1,010
5. Nepal	6.6	250

Source: The World Bank. 2006. *World Development Indicators.* Washington DC. Table 1.1.

Bhutan and the Maldives are two tiny economies of the sub-region. Of these seven, four economies namely Bangladesh, Bhutan, the Maldives and Nepal come under the UN designated category of the least-developed countries (LDCs). If per capita GNI is taken as a measure, Sri Lanka is the most prosperous sub-regional economy (Table 1).

India has had disharmonious relations with some of its neighbors and therefore it did not emerge as the unquestioned economic leader of the sub-region despite being the largest economy. That being said, what happens to the Indian economy influences the other sub-regional economies. Until the early 1990s, India was neither regarded as a rapidly growing economy nor a successful trader. Its export structure was dominated by simple and undifferentiated products, in which the comparative advantage lay in labor-intensive, low-skill and technologically simple products. This languid and dispirited performance of the Indian economy adversely affected the other sub-regional economies. However, with a pick up in Indian economic performance in the 1990s, this scenario has undergone a transformation. Several macroeconomic and financial indicators have recorded a marked improvement. India has booming stock market, whose capitalization grew at a heady pace. Recent rankings show India as one of the three favored destinations of FDI. These positive features have indeed attracted the global and regional attention. Indian economy can now impart its dynamism to the sub-regional economies.

Moving belatedly on the sub-regional economic integration front, the seven South Asian economies signed an agreement to form the South Asian Preferential Trade Area (SAPTA), which became operational in December 1995. After ten years of discussions, deliberations and negotiations, in January 2004 they agreed to forge a South Asia Free Trade Agreement (SAFTA).The ultimate objective was to turn the sub-region into a full-fledged FTA, for which the internal liberalization was scheduled to begin in 2006 in a phased manner. SAFTA came in the wake of India’s existing agreements with Bhutan, Nepal and Sri Lanka. However, it should be pointed out that notwithstanding a great deal of improvement in the recent past, sub-regional economies still maintain fairly high level of protection. Intra-regional trade among them accounts for barely 5 percent of total merchandise trade.

The series of recent regional and bilateral agreements—albeit slow to come about—portend to a transformation in the mindset of the policy mandarins and new dawn in South Asia. They also presage the probability of creation of large integrated economic region in the foreseeable future stretching between Korea in the East and Pakistan in the West (Section 3.4). The economies that were indifferent to the concept of regional integration in the past began to comprehend its benefits and warmed up to the concept of regionalism as well as regionalization. By taking the initiatives and making the agreements enumerated above, South Asian economies have entered the primary stage of economic unification. In the past, this sub-group was regarded as laggards in this respect. They are no longer so. They have shown marked eagerness to participate in the regional economic dynamism.

One of the most striking and noteworthy development in this regard is that the growth rate of India's trade with the two sub-regions, East and Southeast Asia, particularly China, has accelerated significantly after the Asian crisis of 1997-98. Between 1997 and 2004, India's merchandise trade volume with East and Southeast Asia more than doubled. India's trade expansion with China contributed to this sharp increase in its intra-regional trade. In the recent past, the large ASEAN economies (Indonesia, Malaysia, the Philippines, Singapore and Thailand) have become more important trading partners of India than they ever were. However, Japan recorded a reversal of this trend and its trade with India declined in absolute terms over the same period.

Another noteworthy feature is the new trend in the intra-regional FDI flows. The volume of FDI flows between ASEAN and India has started expanding recently. Malaysia and Singapore have emerged as significant investors in India. Infrastructure sector in India is attracting a lot of ASEAN capital. As Indian reforms and liberalization endeavors pick up momentum, FDI inflows are expected to increase. Indian companies are making large investments in the ASEAN economies and China, particularly in the services sectors and labor-intensive manufacturing. Information and communications technology (ICT) and pharmaceuticals are their other favorite areas of investment (Sally and Sen, 2005). After 2000, both China and India have significantly increased their FDI in each other's economy. This trend is expected to accelerate in the near future (Das, 2006)[12]. Strengthening trade and investment relationship is integrating Indian economy with the rest of Asia, which in turn will have a favorable indirect influence over South Asia's integration with the rest of Asia.

[12] See Das (2006), Chapter 5.

5. ASEAN's Role in Advancing South Asia's Regional Integration

The ASEAN economies committed to a formal regional grouping in 1992 in the form of ASEAN Free Trade Area (AFTA), which came into effect in 2002.[13] This was the first institutionalized Free Trade Area (FTA) in region and went through protected negotiations before it came into being.[14] It is still facing and trying to resolve some of those contretemps (Lloyd and Smith, 2004). Initially South Asian economies did not have close economic relations with the ASEAN economies, although India was a Sectoral Dialogue Partner of ASEAN in 1992 and became a full Dialogue Partner in 1995. This elevated the status of interaction of India with ASEAN from the level of senior official to ministerial. This development had taken place under the leadership of Indian Prime Minister Narasimha Rao and his favorite "Look East" doctrine of the early 1990s.

During the ASEAN Summit of December 1997 in Malaysia, when the Asian crisis was still raging, the Summit leaders broached the concept of expansion of formal regionalism. They supported creating the ASEAN-Plus-Three (APT) grouping, which was to include the three large East Asian economies (China, Japan and the Republic of Korea) in the erstwhile ASEAN grouping. The reports of the East Asia Vision Group (EAVG) of 2001 and the East Asia Study Group (EASG) of 2002 strongly promoted the concept of formalized regional economic integration on the ADT lines, deepening and strengthening it and raised the question whether India should be made a part of the proposed expanded country grouping.[15] Whether integration should take the form of a FTA by reducing or removing tariff and NTBs, or go beyond and eventually be an economic community was also debated at length.

Gradual development of progressively closer relationship led to strengthening of economic ties between ASEAN and India. In a more proactive manner than his predecessor, Indian Prime Minister Alal Bihari Vajpayee proposed an ASEAN-India FTA in 2003. The ASEAN-India Summit of November 2004 in Vientiane, Laos, was a defining moment when the top political leaders worked towards deepening the mutual economic relationship. They welcomed *inter alia* cooperation on a long list of regional economic issues. At this Summit the progress in negotiations of the ASEAN-India Trade Negotiating Committee was reviewed, which was found to be slow. This committee was established in 2003 in Bali to draft an ASEAN-India Framework Agreement on Comprehensive Economic Cooperation. The ultimate objective was to create an ASEAN-India FTA so that economic, trade and investment cooperation can be enhanced.

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[13] The founding members of AFTA were Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand.

[14] See Das (1996) for the birth pangs of AFTA.

[15] The East Asia Study Group report was published in July 2002 by the Association of South East Nations (ASEAN) Secretariat in Singapore.

Although negotiations were not smooth and beset with disagreements on some crucial modalities, the ASEAN-India FTA is likely to become a reality in early 2007. If it does come about, this would make a tangible contribution to future integration of South Asia into the rest of Asia. Exploring the feasibility of linking of AFTA and SAFTA could be another channel of sub-regional integration.

An existing instrument of linking AFTA with SAFTA is the BIMST-EC grouping[16]. The BIMST-EC was set up in June 1997 to foster socio-economic cooperation among Bangladesh, India, Myanmar, Sri Lanka and Thailand. In the first summit of the leaders, held in July 2004, membership of Bhutan and Nepal was accepted. Its membership is dominated by South Asian economies. The BIMST-EC was renamed as the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation. The member countries of BIMST-EC are a heterogeneous group, located in a geographically contiguous area. Except Sri Lanka they are mutually connected by land. In January 2004, this group of countries agreed to form an FTA by 2017. This FTA has been so planned that it would go beyond trade expansion by reducing or eliminating tariff and NTBs. Its scope included promotion of trade in services and facilitation of FDI as well as broader economic cooperation. The novel scheme that this group has adopted is that of having what they call a “business visa” for the citizens of the member countries so that mutual trade and investment can be promoted. It could considerably cut the bureaucratic red tape and go a long way in encouraging mutual trade and investment in the BIMST-EC countries.

6. China’s Role in the Regional Integration of South Asia

Political leadership in China took the strategic decision to encouragingly support and participate in the regional economic integration process. Consequently, one of the newest trends to develop in the 21st century is China’s supplanting the US and Japan as the locomotive economy affecting Asian economic growth.[17] This observation applies as much to the East and Southeast Asian economies as to South Asia. Due to the sheer size of its economy, rapid growth rate and openness, what happens in China affects the rest of Asian economy (Humphrey and Schmitz, 2006). Its absorption has become one of the primary drivers of regional growth and development. China’s trade volume and investment expansion with the major regional economies during the decade of 1990s was in double digit. During the 1990s, China’s import growth rate from the South Asian economies was higher than those from East and Southeast Asian economies. Until 1990, China’s bilateral trade volume with India was negligible. It expanded rapidly during 1990s and crossed $10 billion a year in 2005 and China became the third largest trading partner of India after the European Union (EU) and the United States (US), in that order. The two populous Asian

[16] BIMST-EC stands for Bangladesh, India, Myanmar, Sri Lanka and Thailand Economic Cooperation.

[17] See for instance Das (2001); Pangestu and Gooptu (2003); Shafaeddin (2004); Shambaugh (2004) and Shihai (2004).

giants found several areas of complementarities. China has become a large market for the South Asian economies. Likewise, China's and India's mutual investment in each other's economy has soared sharply in a short time span.[18] China is not only successfully playing its role as the regional growth locomotive but is also effectively integrating the sub-regional economies of Asia.

China and India—the 6th and 13th largest economies in the world—have recorded the highest average long-term and medium-term GDP growth rates, respectively, in the recent past. These arriviste economies can potentially usher in an era of new international economic alignments, potentially marking a break with some of the post-War institutions, practices and power structures. This could indeed have decisive and far-reaching global economic and geo-political ramifications. The two economies have deservedly earned the kudos of the policy-makers the world over (Das, 2006).

As these two large regional economies continue to grow in tandem, they would certainly provide growth leverage on their neighbors. This could work directly through bilateral trade as well as indirectly through a web of supply chain linkages between these two economies and elsewhere across the region. While the Franco-German axle propelled the European unification and growth, the US economy played this role for North American Free Trade Area (NAFTA), there is a likely possibility of a China-India axis playing a comparable role for integration and growth in Asia. The economic cooperation that is presently taking place between them is vital for the regional economic integration. Growing rapidly together, the two can potentially become not only an engine of regional growth but also the fourth locomotive for the global economy after the US, Japan and the EU.

While China made rapid progress in advancing its cooperation with the East Asian economies, it lagged in developing comparable relationship with the South Asian economies. In the recent years China made up for this lapse. A China-India Joint Study Group (JSG) was studying a plan for an FTA between the two economies. China's negotiations in this regard with Malaysia, the Philippines and Thailand were also in an advanced stage. The JSG submitted its report in 2005 and was being studied by the two governments. A good deal of complementarity exists between the two economies. An FTA will force business enterprises in both the economies to compete with each other, and in the process render them more efficient. Intra-firm competition will increase total factor productivity (TFP) and eventually enhance economic welfare. A China-India FTA should attract more investment into the region. Whenever it materializes, this FTA would certainly help in bringing in the South Asian economies closer into the fold of the rest of Asia. This form of

[18] See Das (2006), particularly chapter 5 for the current trends in trade and investment between China and India. This chapter also provides statistical data in this regard.

cooperation between the two large Asian economies—that share a long border—need not end at lowering the tariff and NTBs. With time it should develop into a comprehensive framework, promoting market integration, mutual FDI and trade facilitation. The two economies can also work at harmonization of rules.

In promoting regional economic integration, China has clairvoyantly sought the role of a partner, not a leader. Bijian (2005), a noted Chinese strategic thinker, referred to it as peaceful ascendancy, and called it *heping jueqi*[19]. China's political leaders realized that its continued economic development depends on peaceful relations with the other Asian countries. They have shown that being a good regional and global citizen matters immensely to their country. Therefore China accepted ASEAN as the center for regional cooperation structure. By pursuing partnership as an equal in the regional economic structure China can gain respect from its neighboring nations. It can achieve its objective of deeper regional integration without making its partners feel threatened by its hegemonic status.

China's eagerness for closer regional economic integration is reflected in its recent submission of a four-point proposal to deepen the integration in the APT grouping for the consideration of the other APT members. This proposal included creating a free-trade zone in Asia in the short-term, enhancing cooperation in financial and monetary sectors, making use of Asia's newly earned financial resources and setting up an Asian bond market and strengthening cultural, educational, political, and technological cooperation. Asia has enormous potential to upgrade and integrate its financial markets, covering the entire spectrum of equity, bond, foreign exchange and derivative markets (de Brouwer, 2006).

7. Integrating the Regional Economy by Bridging the Sub-Regions

An old RTA that aimed at promoting sub-regional economic ties between six economies of South Asia with those of East is the Bangkok Agreement of 1976. The oldest RTA in the region, the Bangkok Agreement is open to all the regional economies. In a modest manner it attempted to strengthen the sub-regional trading relations between Bangladesh, India and Sri Lanka in South Asia with China and Korea in the East and Lao PDR in Southeast Asia. China did not join the Bangkok Agreement until 2000. The present membership of the Bangkok Agreement comprises two of the rapidest growing economies of the region, China and India (Das, 2006). Although its consumer base is huge at 2.9 billion, three of the member economies are of small size. The Bangkok Agreement was not successful in achieving its objectives and needed to be reinvigorated because it suffered from limitations like small product coverage, shallow tariff concessions and not dealing with the NTBs. Cognizant of this fact, members conducted a fresh

[19] In Mandarin *heping jueqi* means peaceful ascendancy.

round of negotiations in July 2004 to make the agreement wider and deeper, which could improve its functionality. In this round of negotiations members also decided on future modalities of negotiations and committed themselves to the norms consistent with the guidelines of the World Trade Organization (WTO) on RTAs. They decided on not raising trade barriers against the non-members regional economies. If it expands, the Bangkok Agreement has potential of integrating some South Asian economies with some East Asian ones in a RTA. It does not have potentialities of pan-Asian integration of South Asian economies.

In future, the three emerging sub-regional agreements, namely SAFTA, APT and the Bangkok Agreement, could advance and come together and integrating the region. Plans and agreements in this regard have been on the anvil and gradually progressing. This in turn could bring South Asian economies in the fold of the East and Southeastern economies. If successful, this could be a channel of integration of the South with the rest of the dynamic Asian economies. It is well within the realm of possibility because four regional economies (China, India, Korea and Sri Lanka) enjoy memberships in at least two of the sub-regional groupings.

7.1 Making ASEAN the Nucleus of Regional Integration

The developments after 2001 show that the locus of prospective sub-regional integration can take the following line. Notwithstanding the difficulties, the ASEAN Free Trade Area (AFTA) has come into being. It has been making overtures to expand and include the other large regional economies and sub-regions, eventually forging a pan-Asian economic region by 2020. China and ASEAN signed an FTA agreement in November 2002. This FTA is scheduled to come into force in 2010. When it does, this FTA will be among the largest in the world, with 1.7 billion consumers. With the trade of $1.2 trillion, this FTA will be the third largest in the world after the EU and the NAFTA.

In October 2003, China, Japan and the Republic of Korea (hereinafter Korea) signed an agreement to form a larger FTA with the ASEAN economies. By 2020, this APT is scheduled to come into effect. In addition, in September 2003 in Jakarta, an FTA comprising APT and India, the largest South Asian economy, was planned and agreed. It is going to be implemented between 2012 and 2017. This large FTA, that will include ASEAN, China, Japan and Korea and finally India will be an ASEAN-Plus-Four (APF).[20]

The APF grouping is the newest regional initiative. It succeeded in integrating four large Asian economies with ASEAN, a functioning FTA. This structure of APF made it an imperious regional grouping. Second, the APF prepared the region for an East, Southeast and South Asian

[20] See Bonapace (2005) and Cheng (2005) for greater details.

integration, which is an invaluable accomplishment. The network of FTAs and BTAs between the members of APF grouping is sure to weave the APF economies and the sub-regions together closely. The APF can potentially be developed into a comprehensive regional partnership, eventually facilitating free pan-Asian flows of goods, services, factors of production and ideas. This could be the future objective of the APF economies.

7.2 Smaller RTAs Integrating the Region

The frequency of new regional integration initiatives was so high that it became difficult to keep exact count of the FTAs and BTAs in the region. According to one estimate, between 2000 and 2005 a total of 31 such agreements proliferated that involved the ASEAN economies, China and India (Angtkeiwicz and Whalley, 2005). This number is a conservative estimate because it did not include the individual BTA initiatives of the ASEAN economies.

Several BTAs between Japan, Korea and China were under different phases of study or negotiations. India gave up its traditional indecision and unwillingness for regional integration and began actively pursuing links with other regional economies. Between 2000 and 2005, China and India were involved in 9 and 15 such agreements, respectively. BTAs between China-India, India-Korea and India-Japan were under study, or on the drawing board (Evans *et al,* 2006). Japan began negotiations for an FTA with Korea in 2002; the negotiations got stalled, languished and have now restarted. One disadvantage with the BTAs is that the economic complementarities in the region cannot be exploited.

8. Growth Bridge between the South Asia and East Asia

Above exposition (sections 6 and 7) provided an inventory of the important regional events that could be taken for steps towards pan-Asian integration. This sequence of events leads one to believe that in the integration process of South Asia with the more dynamic economies of the East, the Southeast Asian economies—or the ASEAN—are going to function as a bridge. This idiosyncratic integration process is being supported and promoted by China, the most dynamic regional economy. An empirical exercise conducted by Roland-Holst *et al* (2005), which used the new GTAP (version 6) data base with a dynamic global model, concluded that the ASEAN economies will have the most to gain from this paradigm of Asian economic integration. The reason is that ASEAN is functioning as a “growth bridge between the larger dynamic emerging economies” which includes China and India. The ASEAN economies are aptly suited for this role because of, first, their geographical location and, second, their established comparative advantage in resources, commercial facilitation and specialization in intermediate production. This pattern of regional integration would transmit growth externalities the low-income and slow-growth ASEAN economies like Cambodia, Lao PDR and Myanmar.

A tradition of high protection resulted in greater economic isolation of South Asian economies form the rest of Asia. Also, South Asian economies have had larger dependence on the extra-Asian markets. Given this past, global tariff reduction would benefit the South Asian economies a great deal. However, intra-regional trade liberalization and trade facilitation—a product of regional integration—in Asian would provide large real income benefits to the South Asian economies. The empirical exercise cited in the preceding paragraph inferred that percentage real income gains to South Asian economies would be less than those for the Southeast Asian economies or the East Asian economies, but the regional trade share of South Asian economies will increase dramatically.

9. Conclusions

Asian economy was characterized by smooth trade flows and active commerce during the preceding millennium. During the early part of this millennium, both China and India had emerged as countries and trading economies. Pax Mongolica brought together different regions of Asia—and also linked it with Europe—leading to the genesis of a global economy. The present endeavors of South Asian economies to integrate with the rest of dynamic Asia is an attempt to return to the past.

Institutionalized regionalism was slow to lay down its roots in the contemporary Asia, if anything it was much slower in South Asia. This sub-group of Asian economies was apathetic and ambivalent and did not show any interest in regionalism until recently. During the post-War period, South Asia and East Asia followed characteristically different growth strategies. Consequently, the South Asian economies lagged way behind the so-called “miracle” economies of East and Southeast Asia. The differing growth strategies and patterns also influenced regional integration paradigm in the different sub-regions of Asia. There were definite reasons behind belated regionalism in Asia. Aspirations of creating a pan-Asian economy were also slow to surface.

After following half a century of diverse as well as similar growth paths, in the initial years of the 21st century economies of East, Southeast and South Asia found themselves at dissimilar stages of economic development, having a great deal of complementarities. Substantial complementarities also arose from diversity in their factor endowments. The regional economies became cognizant of the fact that by developing close inter-linkages, they could astutely exploit the complementarities among them for mutual benefit. This realization *inter alia* stimulated the regionalization endeavors.

India is by far the largest SAARC economy and has recently been playing a decisive role in the sub-regional integration as well as in integrating South Asian economies with the rest of Asia. Although India did not emerge as a leader of the South Asian economy and had the disadvantage of having disharmonious relations with the neighbors, it was evident that what happens to the Indian economy influences the other sub-regional economies. Moving belatedly on the sub-regional economic integration front, the seven South Asian economies signed an agreement to form the South Asian Preferential Trade Area (SAPTA), which became operational in December 1995. After ten years of discussions, deliberations and negotiations, in January 2004 they agreed to forge a South Asia Free Trade Agreement (SAFTA). The series of recent regional and bilateral agreements—albeit slow to come about—portend to a transformation in the mindset of the policy mandarins and new dawn in South Asia. They also presage the probability of creation of large integrated economic region in the foreseeable future stretching between Korea in the East and Pakistan in the West

ASEAN's role in advancing South Asia's regional integration has been remarkable. During the ASEAN Summit of December 1997 in Malaysia, when the Asian crisis was still raging, the Summit leaders broached the concept of expansion of formal regionalism. They supported creating the ASEAN-Plus-Three (APT) grouping, which was to include the three large East Asian economies (China, Japan and the Republic of Korea) in the erstwhile ASEAN grouping. The reports of the East Asia Vision Group (EAVG) of 2001 and the East Asia Study Group (EASG) of 2002

China has successfully supplanted the US and Japan as the locomotive economy affecting Asian economic growth. Due to the sheer size of its economy, rapid growth rate and openness, what happens to China affects the rest of Asian economy. China is not only successfully playing its role as the regional growth locomotive but is also effectively integrating the sub-regional economies of Asia, without appearing to be a hegemonic. While China made rapid progress in advancing its cooperation with the East Asian economies, it lagged in developing comparable relationship with the South Asian economies. In the recent years China made up for this lapse.

The ASEAN group is developing into the nucleus of Asian integration. It may well become a growth bridge between the South and East Asia. In October 2003, China, Japan and the Korea signed an agreement to form a larger FTA with the ASEAN economies. By 2020, this APT is scheduled to come into effect. In addition, in September 2003 in Jakarta, an FTA comprising APT and India, the largest South Asian economy, was planned and agreed. It is going to be implemented between 2012 and 2017. This large FTA, that will include ASEAN, China, Japan and Korea and finally India will be an ASEAN-Plus-Four (APF). It is regarded as a major step forward in integrating South Asia with the rest of Asia. In addition, between 2000 and 2005 a large number of smaller RTAs and BTAs have been signed in Asia, which are effectively integrating different sub-regions of Asia.

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