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# LEP2:
# Phase Two of South Asia's "Look East" Policies?

By Pradumna B Rana and Chia Wai Mun

## *Synopsis*

*"Look East" policies implemented by South Asian countries in the early 1990s have had positive impacts on their economies. These countries now need to move on to the second phase of their "Look East" policies.*

## *Commentary*

SOUTH ASIAN countries initiated their "Look East" policies to promote closer relations with East Asia as part of their economic reform programme of the 1990s. India announced its "Look East" policy in 1991 and subsequently other countries followed suit. Although a lot more needs to done, significant steps were taken by these countries to deregulate their industrial sectors and to reduce tariffs. These policies have had significant positive impacts on their economies.

International trade between South Asia and East Asia has surged, albeit from low bases, and China has become the largest trading partner of India. Foreign direct investment (FDI) between countries in the two regions has also increased, and Singapore has become the second largest source of FDI to India. Tourism and travel is also surging. India holds summit-level dialogues with ASEAN and is a member of the East Asia Summit. India has also started negotiations to join the Regional Comprehensive Economic Partnership (RCEP) which is a free trade agreement among ASEAN and its six dialogue partners (Australia, China, India, Japan, Korea, and New Zealand).

### Traditional vs new paradigm in trade

But now the way goods are produced and traded internationally is no longer the same as before. Under the traditional theory of comparative advantage, developing countries produced labour intensive goods which they then exchanged for relatively capital and skill intensive goods produced by the more advanced countries. In this model, all separate tasks involved in producing a good was done entirely at home.

Nowadays production is spliced and diced into separate fragments that can be spread around the world. Nike is a well-known example of this phenomenon. While research and design of shoes remain in the United States, most of Nike's production is in facilities spread around 50 developing countries mostly in Asia and Latin America. iPhone production is another good example. Its parts and components are produced by nine companies in five countries (China, Korea, Japan, Germany and the US) with final assembly in China.

The major catalysts for product fragmentation are the reduction in transport and logistics cost and advances in technology which have made slicing and dicing of products possible. A noted international trade economist, Richard Baldwin, has also highlighted the importance of information, communication, and technology (ICT) revolution. Cheaper communications have allowed firms to manage supply chains over large distances. Companies have also discovered that they can build plants to manufacture parts and components in cheap locations abroad, and ship them either back home or elsewhere for assembly into the final product.

**Second phase of Look East Policies: LEP2**

East Asia is dense with production networks. The region accounts for roughly 50 per cent of global production network or supply-chain trade with China and the ASEAN countries in the lead. Such networks have contributed to deepening regional economic integration and brought unprecedented prosperity to the region.

To benefit from these developments in East Asia, South Asian countries need to embark on the second round of their "Look East" policies or LEP2. This will involve two approaches to (i) link themselves to production networks in East Asia and (ii) develop new production networks within their region. Such policies would allow both regions of Asia to benefit not only from the static complementarities of the traditional trade theories but also the dynamic complementarities associated with the new product fragmentation theories pioneered by Jones and Kierzkowski.

LEP2 in South Asia should comprise at least five policies. First, South Asian countries should complete the economic reform process begun in 1990s. In the new trading environment, foreign investors shop around for the most favourable locations for production of parts and components. It is, therefore, important for host countries to provide a favourable business environment. After having made significant progress in deregulating industries and reducing tariffs, South Asian countries need to implement the so-called second generation reforms to improve governance systems at various levels – civil service, bureaucracy, and public administration.

They also need to improve the environment facing the private sector through regulatory, labour market, and legal reforms. World Bank's Doing Business Survey 2012 shows that in terms of overall ranking, on average South Asia ranks lower than East Asia and Latin America. The only region that fares worse than South Asia is Africa. India's ranking is 132 similar to that of Cambodia, Indonesia, and the Philippines.

Second, South Asian countries should improve their information and communications technology (ICT) systems to coordinate supply chains more efficiently. Various indicators published by the International Telecommunication Union suggest that although South Asian countries (especially Maldives and Sri Lanka) perform better than Cambodia, Laos and Myanmar, they are way behind other East Asian countries.

Third, South Asian countries should strive to reduce logistics costs. With product fragmentation, efficient logistic service is a key determinant of a country's competitiveness. Logistic performance index published by World Bank suggests that on average South Asia lags behind all other developing regions except Africa.

**Connectivity between South Asia with East Asia**

Fourth, South Asian countries should support on-going efforts to enhance physical connectivity with East Asia as this would reduce trading costs between the two regions. Two projects to link ASEAN to India, one maritime and other a road project, are at early stages of implementation. Additional economic corridors to link China, ASEAN, and South Asia should be considered.

Finally, India, the largest economy in South Asia, should actively lobby and negotiate its participation in various ongoing efforts to promote regional financial cooperation in East Asia. These include possible associate membership in the ASEAN+3 finance ministers' process and pledging resources to the $240 billion crisis fund in East Asia.

LEP2, would deepen South Asia's economic integration with East Asia and lead to a win-win situation for all. It would also reinvigorate economic integration in South Asia which is among the least integrated region of the world. Finally, LEP2 would poise South Asia and East Asia to benefit from the gradual but encouraging opening of Myanmar, a node between the two regions.

*Pradumna B. Rana is Associate Professor at the S. Rajaratnam School of International Studies (RSIS), Nanyang Technological University (NTU). He is also the coordinator of economic multilateralism and regionalism studies at the RSIS' Centre for Multilateralism Studies. Chia Wai-Mun is Assistant Professor at the Division of Economics, NTU. This commentary is based on their RSIS Working Paper Number 253, January 2013.*