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Comments on “Economic Implications of Deeper South Asian-Southeast Asian Integration: A CGE Approach” by Ganeshan Wignaraja, Peter Morgan, Michael G. Plummer, and Fan Zhai

South and Southeast Asia have experienced high economic growth and rapid development over the last couple of decades. This positive development has been accompanied and caused by various changes in economic policies, one being a change towards a more outward looking development strategy.

The authors use this development as a starting point to examine if a deeper integration between South and Southeast Asia would lead to further high economic growth. The estimated effects that come out of the analysis are strikingly large.

The question is then why we don't see any strong willingness to increase integration between these two areas? Here it would have been good to get more background on the political context. My own impression is that Southeast Asia is primarily interested in deeper integration with Northeast Asia. The initiatives and discussions to improve integration with Northeast Asia takes a lot of resources, and leaves considerable less room for a focus on integration with South Asia.

It should be noted that the current integration between South and Southeast Asia is low. For instance, the paper mentions that Southeast Asia's share of South Asia's trade has gone from 11 percent in 2000 to 10 percent in 2012. Moreover, the share of South Asia in Southeast Asia's trade has increased but only from 2 to 4 percent. It is important to try to understand why trade is low between the two regions if we want to be able to speculate on the possible effects of further integration.

One important reason to the current low integration is that a large part of international trade is in manufacturing products, and South Asia has, by and large, never been able to develop any more substantial manufacturing sector. As a result, international trade tends to be relatively low in South Asia. Moreover, the development of large production networks in Northeast and Southeast Asia has boosted trade further, but South Asia is left largely outside of these networks.

One implication of the different economic structures in South and Southeast Asia is that the risk of trade diversion is presumably relatively high if tariffs and non-tariff barriers were to be removed between the two regions. Hence, it is quite possible that global welfare will be a negatively affected by trade liberalization between South and Southeast Asia. How much welfare will increase within the two regions is uncertain.

The main reason why the manufacturing sector is underdeveloped in South Asia, and thereby why trade is low, is to be found in the overly regulated domestic economies. India is a good example where The Industrial Dispute Act includes 55 central authority laws and 150 provincial laws making India having one of the most regulated labor markets in the world. Similar regulations can be seen across South Asia and in many different areas of the countries' economies.

Another problem that hurts manufacturing in South Asia is the poor state of infrastructure. Transport costs are about 20 percent higher in India than in Thailand and about 30 percent higher than in China. It is therefore interesting to see that the authors find substantial growth effects from improved infrastructure. The results seem reasonable considering the problems mentioned above. However, such improvements in infrastructure have of course nothing to do with a trade agreement between the two regions but will take place at the will of the different governments.

The implications of the poor state of manufacturing in South Asia are twofold. Firstly, it is uncertain if liberalization of trade regimes will have much impact on integration unless it is accompanied by domestic liberalizations of goods and factor markets. Secondly, it is quite possible that such domestic liberalizations alone will have much larger positive effect on incomes in South Asia than what can be expected from changes in the trade regime.

This brings us to the question of what is the most relevant alternative to trade liberalization between South and Southeast Asia. The paper uses no liberalization as the benchmark. It would have been interesting to see how unilateral trade liberalizations would affect incomes and welfares. In other words, how would incomes in, for instance, India be affected by a decision to lower India's tariffs and non-tariff barriers to the rest of the world? It is quite possible that such unilateral actions would generate substantial welfare improvements. Whether the improvements would be higher than improvements from integration with Southeast Asia is difficult to speculate about.

Another issue that one needs to think about is whether Southeast Asia needs another regional trade agreement. The number of such agreements has exploded in the last decade and many observers talk about a situation where it is becoming difficult for firms to navigate; to know what tariffs that applies to what products in trade with different countries. The problem is exacerbated by complicated rules-of-origin issues.

To sum up, improved infrastructure and further trade liberalizations will be important if the high growth is to be maintained in South and Southeast Asia. Improved infrastructure requires financial resources and political will but its implementation is not dependent on international trade agreements. Moreover, it is in my view uncertain if trade integration between the two regions is the best way to achieve a more open economic environment.