

INDIA LOOKS EAST: STRATEGIES AND IMPACTS

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The Treasury

Introduction

India's economy continues to grow rapidly, thanks largely to the economic reforms initiated in 1991. India's 'Look East' policy (LEP), which seeks to establish closer ties with East Asian economies, is part of its reform package. Reform, rapid growth and 'look east' have shaped India's international economic policy, transforming India's economic relations with East Asia.¹

This paper explores India's LEP and its impact on East Asia. In so doing, the paper summarises India's long-term growth prospects before analysing the LEP, including its objectives, strategies and approaches to implementation. Finally, the paper explores the impact of the LEP on both India and East Asia, particularly the formation of an Asian economic community. The concluding section summarises broad observations of India's East Asia economic relations under the LEP, and draws implications for the relationship in the future

India's Reforms and Its Continuing Economic Rise

The Reform and Economic Transformation

India's reform has led to economic transformation at home and to growing influence abroad, setting up the basis for a transformed relationship with East Asia.²

India began significant economic reforms in 1991.³ It has since been unravelling strict government regulations and protection, which had insulated India's business from competition, innovation and profit seeking. The pre-reform centralised economic system put the government in direct control of business activities.⁴ As a result, business was unable to make essential decisions pertaining to corporate financing, investment, production and the hiring and firing of workers. After a decade of reforms, India's economic system has become increasingly decentralised, and more decision-making power has been returned to companies. Decentralisation has enabled Indian businesses to explore commercial and profit opportunities.

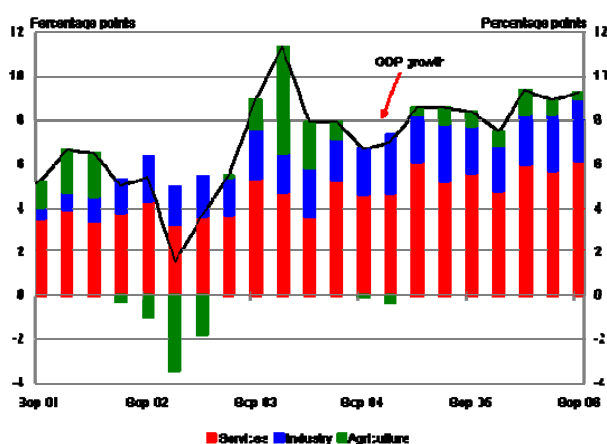
These reforms have led to a gradual opening of the Indian economy to international competition. When sheltered by government protection, Indian industries

were highly inefficient and uncompetitive. In the face of greater competition since the reforms, more and more Indian industries have revamped themselves by reorientating production and streamlining their workforces (shedding redundant workers) in the past few years. Indian businesses used to fear competition. Now, they more confidently compete, especially in the industries that require highly skilled labour and are capital intensive.⁵ This new-found confidence has encouraged a growing number of internationally competitive Indian businesses to support trade liberalisation at home and abroad.

India's foreign policy thinking has also changed dramatically. The collapse of the Soviet Union triggered a realignment of India's international relations. The successful pursuit by many of its Asian neighbours of outward-looking development strategies made India rethink and eventually abandon its post-war self-reliance development strategy pursued under the governments led by Jawaharlal Nehru and Indira Gandhi. With business and trade now the drivers of India's new international economic relations, pragmatism prevails in the thinking of India's foreign policymakers. Indian leaders seek to promote the country's international economic relations through trade liberalisation under multilateral frameworks such as the World Trade Organization (WTO). They also seek other channels for promoting trade, including FTAs.

The result of India's reform and opening up speaks for itself. India has had outstanding economic performance since 1991, with gross domestic product growing at an average of 6 per cent a year and 7–9 per cent in recent years (Figure 1).

Figure 1: India's GDP Growth, 2001 - 2006



India's international trade, which has grown by 13 per cent a year since 1991, has been a driver of its overall growth. Previously, India had belonged to a global group of slow growers, having a highly volatile 'Hindu rate of growth'⁶ averaging a low 3 per cent a year from independence in 1947 to 1990, the eve of reform. Foreign trade was never perceived as important, and understandably contributed little to overall growth. Rapid growth has now put India in the league of Asia's 'tiger' economies, with its huge consumer market of 1.1 billion people, 200–300 million of whom form a middle class, which continues to grow. India's international competitiveness is visible and rising in a wide range of areas, including services, software and IT support, metal and energy processing, and biological, space and nuclear technologies.

Is India's Growth Sustainable?

It is natural to ask whether India's current economic performance can be sustained in the long term, given some false starts in the past and the enormous development challenges it still faces.⁷

India faces enormous challenges in tackling impediments to future growth, including poor physical and social infrastructure, rigid labour laws and bureaucratic red tape. These impediments continue to hold the country back from achieving sustained growth.⁸

- > Poor physical infrastructure, including roads, water and power supply, form the most visible bottlenecks to India's growth.
- > The lack of social infrastructure, including health, education, social security and justice, requires the government to spend more and deliver better services.
- > India's rigid labour laws and regulations impose high costs on production and particularly limit the expansion of the manufacturing sector.
- > India's investment regime is not yet transparent. Bureaucratic red tape remains rampant: not only does setting up a plant require a large number of permissions, but its daily operations involve many different government departments.

Reforms that successfully tackle these impediments will help India sustain long-term growth. There are signs that India has made progress in tackling difficult reforms. It has begun investing heavily in its physical infrastructure and improvements are visible, particularly in roads and highways connecting big cities. Sustained growth, however, requires improved government capacity, including professionalism and transparency, in

service delivery. It also entails reform of the institutional framework that governs business and investment activities. This is a difficult area in which to make substantial change. For instance, labour law reform is badly needed to make firms more flexible and competitive. Major political parties have discussed these reforms over the past 10 years, but as yet no action has been taken.⁹

The difficulty inherent in labour law reform illustrates the point that, in India's political system, decision making is often consensus-based. Consensus building takes time, and often gets gridlocked. On the other hand, India has demonstrated that, once a decision is made, the political process of consultation and consensus building allows India to move quickly and makes change sustainable.

Currently, India's trade liberalisation is credited with contributing to only part India's economic growth. There have been high expectations that further reforms to India's investment regime will lead to a significant rise in foreign direct investment, which in turn will have a positive impact on India's economic growth. While these topics are beyond the scope of this paper, there is little doubt that economic reform and liberalisation will affect India's growth and international business competitiveness.

Demographic Dividend, Productivity Gains and International Competitiveness

India has many favourable factors that bode well for its long-term economic growth and its international competitiveness.

India has a demographic dividend thanks to its young population – mostly under 25 years old. While this presents challenges to employment, it also means that high productivity and low wages can coexist to facilitate India's growth over the next few decades. The combination of India's skilled labour force and English-speaking population makes it easy to undertake international business. India's human resources have become important in mobilising international capital and are the subject of many discussions on trade liberalisation, including India's economic cooperation and integration with the East Asian economies.¹⁰

India's growth so far has been based on productivity gains, underpinning the viability of the growth. India has used its capital relatively efficiently, with the incremental capital:output ratio falling from 4.5 to 3.5 during the reform period.¹¹ Comparing India's growth with China's is also revealing, particularly about India's relative strengths and weaknesses.¹² There are views that China's growth is more

government-led, thus shackling its independent businesspeople. India has empowered them.¹³ India tends to achieve its growth more efficiently than China.¹⁴ India achieves 7–8 per cent growth in gross domestic product from a 30 per cent savings rate plus 1 per cent from foreign direct investment. China achieves 9–10 per cent growth from a 50 per cent savings rate plus 4 per cent from foreign direct investment.

Overall, high growth is most likely to continue in the medium term, particularly as India is making an effort to ease its infrastructure bottlenecks. According to some World Bank estimates, improvements in physical infrastructure will contribute 1 per cent or more to India's growth in the medium term. In the longer term, its growth prospects will be even brighter if deeper reforms can be undertaken, especially in the areas of labour laws and government service delivery. All of these changes will drive the continuing rise of India's international business competitiveness.

India's reforms and domestic development provide the background as well as the overall framework within which its international economic policies can be understood. The LEP is an integral part of India's reform package, and its implementation has resulted in the reorientation of India's foreign economic policy. The policy has had a significant impact on the country's domestic development, including the reform process.

The Look East Policy

The motivation and rationale for the India's LEP as well as its objectives and its implementation strategies are the focus of this section. Of particular interest is India's pursuit of integration with East Asian economies as a means to realise its aspirations of becoming a global economic superpower.

Policy Background

For the past 15 years India has pursued a foreign economic policy that facilitates closer economic and institutional ties with East Asia.

The year India began its economic reforms also marked a watershed in its international economic policy strategy. Until 1991, India's development strategy had been industrialisation through import substitution. The pursuit of self-reliance with minimum external resources led to high tariffs, licences and quotas being used to control imports and foreign investment and to further the development of India's

indigenous industries. Furthermore, political goals and ideological pursuits set the boundary and direction for India's international economic relations. Its international economic policy was a means to achieve its political and ideological objectives in the international arena, be it de-colonisation or non-alliance.

With reform India has gradually liberalised its economy by reducing tariffs and relaxing controls over foreign direct investment. The average tariff rate fell from as high as 100 per cent before reform to around 24 per cent more recently. This rate is expected to fall further, to around 10 per cent, over the next few years. While non-trade barriers and quantitative restrictions affected 39 per cent of imports in the 1990s, they affected only 4 per cent in 2003. India has become a freer market. Government controls on foreign trade and investment remain, but they have become less rigid, which has facilitated rises in both foreign trade and investment. More Indian firms also invest overseas.

What is 'Look East'?

India's 'Look East' policy has been spelled out numerous times, and in his 2003 speech at Harvard University India's former foreign minister, Yaswant Singh, summarised it as follows.

In the past, India's engagement with much of Asia, including South East and East Asia, was built on an idealistic conception of Asian brotherhood, based on shared experiences of colonialism and of cultural ties. The rhythm of the region today is determined, however, as much by trade, investment and production as by history and culture. That is what motivates our decade-old 'Look East' policy.¹⁵

The initiation of the LEP represented a reorientation of India's foreign economic policy strategy after the Cold War. The LEP signalled the end of India's previous pursuit of self-reliant economic development, and the start of an era in which India strived to take advantage of new opportunities from international trade and investment. The LEP also sent a strong signal that East Asia would be integral to India's economic opening. The region would no longer be overlooked, as it had been by India's previous foreign economic policy, but would now be regarded as a source of new business opportunity and inspiration for economic development.

There are good reasons behind India's push to 'look east'. East Asia is close to India geographically – India shares land borders with Burma and Thailand, and sea borders with them as well as Malaysia and Singapore. Trading relationships between

India and some ASEAN member countries can be traced back more than a thousand years and have profoundly affected one another's linguistics, religion, culture and business. South-East Asia has been a destination of Indian migrants for centuries. The LEP took this into account and the potential role the diaspora could play in bridging the gaps between India and their host countries.

The gaps were wide in the early 1990s. As India 'rediscovered' South-East Asia, India was astonished to find that the region was no longer an economic backwater, as India had viewed it in the 1940s and 1950s. It had become a dynamic and prosperous region that enjoyed more than 2–3 times the income of India and had developed superior social and economic infrastructure. Engaging East Asia became a predominant ambition among Indian policymakers, who wanted to repeat its growth story.

India's desire to engage East Asia also has strategic considerations. Particularly since the early 2000s, India has been concerned that, if the WTO trade negotiations failed, it would be left alone to face growing protectionism in Europe and North America. While India has sought to negotiate FTAs with as many countries as possible to keep its options open, it found East Asian countries were the most enthusiastic potential partners.¹⁶

The China rivalry factor – a sense of rivalry felt by India towards China and its successful push for closer economic ties with South-East Asia – initially figured prominently in India's push towards ASEAN. India felt forced to counter China's push into the rest of Asia with moves of its own.¹⁷ BIMSTEC and the Mekong–Ganga Cooperation, for instance, are regional cooperation agreements initiated by India. Part of their initial purpose was not only to exclude China's participation, but also to counter its lead in the Greater Mekong Subregion program, which also involves Cambodia, Laos, Vietnam, and Burma in the development of the subregion.

Policy Objectives

By 2005 the LEP had already moved beyond its initial goal of tapping into the opportunity presented by East Asia's growth, which is still important. The policy now serves a much broader agenda, particularly as India's economy continues to grow. The LEP is pursuing four broad objectives: reform and liberalisation, sustained rapid growth, regional economic integration and equity-based development.

The four objectives are not mutually exclusive but reinforcing. The emphasis placed on each of the objectives has been different at different points of time during the past 15 years. More recently, the emphasis has been on India's economic integration with East Asia. Rapid growth has renewed India's aspiration to be a global superpower, which it can realise through integration with East Asia, while continuing to pursue the other objectives.

Reform and Liberalisation

Closer economic ties with East Asia require greater effort on India's part to liberalise trade and investment. The LEP objective of economic reform and liberalisation supports India's effort to lower trade barriers and liberalise investment regimes. This gained further impetus when India and all major East Asian economies began free trade negotiations in the early 2000s. India's new-found enthusiasm for FTAs injected new dynamism into its LEP, which in turn had an impact on India's reform and liberalisation.

Sustained Rapid Growth

Tapping into East Asia's growth was an important trigger for India's engagement with its economies. With the Indian economy taking off from the early 2000s, India has increasingly turned its focus to sustaining its rapid growth. Strong economic ties with East Asia would position India well for accessing growth opportunities in Asia.¹⁸ India is also wooing East Asian investment as it tries to build infrastructure in the transport, communications and power sectors to keep pace with its expanding economy.¹⁹ India believes East Asia holds a key to India's sustained economic growth, particularly when international economic activities are becoming more critical to India's own growth, and other regions are growing at a much slower pace and becoming more protectionist.

Regional Economic Integration

The third objective of the LEP is to pursue economic regionalism with East Asia. This is partly a reaction to the formation of trade blocs in Europe and North America, and partly serves as a platform from which to promote India's growing superpower status. In the face of an increasingly fragmented world, India feels that its grouping with East Asian countries would enhance its position relative to other regional partners.²⁰ There

are certainly strong views in India that the time has come for Asia to form a trade bloc to become the third pole of the world economy.²¹ In the words of Manmohan Singh, India's current Prime Minister, 'this century is going to be Asia's century'. He also said that India, along with China, 'is going to be a major economy of this century. This is part of our "Look-East" policy'.²²

Equity-Based Development

The LEP is seen as instrumental in addressing internal disparity in India's development, and fostering more equity-based growth.²³ The economic development of India's seven north-eastern states in particular lags behind the nation's development. They have felt neglected in terms of investment and government spending for some time. Through the LEP, India hopes that linking its north-eastern region with peninsula South-East Asia will kick-start economic development, and help the seven states to develop infrastructure, logistics, agrobusiness, trade, investment and other commercial activities. Trade with South-East Asia also has the potential to turn the region from land-locked to land-linked²⁴, providing India with land routes to Burma, Thailand and other peninsular South-East Asian countries. While the LEP is an initiative from the central government, the seven north-eastern states are strong supporters of the policy.

Approaches

How has India pursued its LEP objectives? The roles played by the LEP's geographical focus, negotiation tactics and subregional links are now explored.

Geographical Focus

In approaching East Asia, India initially chose to focus on ASEAN. This was because ASEAN members were the first ones to respond favourably to the LEP. India soon found Thailand and Singapore the most receptive countries among the ASEAN members to India's approach for economic cooperation.²⁵

India-ASEAN economic relations improved over the years, leading to multifaceted institutional arrangements being developed by the two sides. India was accepted by ASEAN as a sectoral dialogue partner in 1992, a full dialogue partner in 1995, a member of the Asia Regional Forum in 1996, and a summit partner in 2002.

Since 2003, India, ASEAN and its individual member countries have agreed to, and begun negotiations on, FTAs after signing the Framework Agreement on Comprehensive Economic Cooperation. India and ASEAN agreed to implement an FTA for the ASEAN-5 by 2011 and for all ASEAN member countries by 2016. The Framework Agreement announced an early harvest program of immediate deliverables and unilateral trade preferences by India in favour of the least developed members of the grouping.

To date, India has concluded the Comprehensive Economic Cooperation Agreement with Singapore (2005). It is also in an advanced stage of FTA negotiations with Thailand, and has started FTA negotiations with Indonesia and Malaysia. FTA negotiations between India and ASEAN are also well under way.

India's East Asia strategies have gradually moved away from solely focusing on ASEAN since the early 2000s, with its warming relations with other East Asian economic powers, particularly China and Japan. India and China have a joint study group evaluating the potential for a bilateral FTA. India is also investigating a comprehensive economic agreement with South Korea and Japan.²⁶

Negotiation Tactics and Sectoral Focus

India favours FTA negotiations as a means to get involved in and shape the course of its economic integration with East Asia, which has gained impetus since the early 2000s. Its preference for FTAs arises from its frustration with the slow WTO process, and a fear of rising regionalism around the world that would exclude India. FTAs with East Asian countries would provide India with a way to hedge its bets and keep options open in case the WTO negotiations fail.²⁷

When negotiating FTAs, India takes the position that service trade is as important as trade in goods. India's trade negotiators believe the country's economic strength lies in its services sector. They prefer to use the Comprehensive Economic Cooperation Agreement as a template for an FTA, because of its comprehensive coverage of goods and services trade as well as investment.²⁸ An FTA that focuses on only goods would add little value to the Indian economy.

India sees the merit of having an FTA that covers East Asia and India, but at this stage finds coordinating the different interests for such an undertaking a slow and daunting process. Bilateral FTA negotiations present an easier path to advancing the

FTA negotiations.²⁹ This explains why India embarked on bilateral negotiations with individual ASEAN members, particularly Singapore and Thailand, after initial FTA negotiations with ASEAN slowed. India hopes that its bilateral FTA negotiations with individual ASEAN members will set a basis for the ASEAN–India FTA.

Using the same line of thinking, India is also negotiating or studying the feasibility of bilateral FTAs with ASEAN, Japan, China and South Korea that would lead to an eventual East Asia–India FTA.

Subregional Links

India promoted the Bay of Bengal Multi-sectoral Technical and Economic Cooperation to establish economic links with peninsula member countries of ASEAN to boost the development of its seven north-eastern states. When India initiated BIMSTEC in 1997, it received strong support from Thailand, which also saw it as a political and economic forum to bridge South-East Asia and South Asia.³⁰

Competition with China strongly influenced India's BIMSTEC initiative. For historical reasons, India did not like to engage with China. BIMSTEC was designed to partly counter the proposed 1997 Bangladesh, China, India and Burma initiative. The design was such that BIMSTEC was virtually the South Asian Association for Regional Cooperation (SAARC)³¹ minus Pakistan plus Thailand and Burma.

The Mekong–Ganga Cooperation was another India initiative, announced in 2000³² and designed to partly counter the Greater Mekong Subregion growth area, which also involves China. With members including India, Cambodia, Laos, Burma, Vietnam and Thailand, the Mekong–Ganga Cooperation has all of the Greater Mekong Subregion members except China.

BIMSTEC held its first summit in Bangkok in 2004, which identified five broad areas of cooperation to bridge the gaps between South-East Asia and South Asia: fisheries, information and communication technologies, transportation, textiles, tourism and trade.³³ The Mekong–Ganga Cooperation has made little headway, reasons for which are mentioned later.

Grand Strategic Goals for Regional Cooperation

What are India's grand strategic goals for regional cooperation under its LEP?

As already noted, India is pursuing an FTA covering East Asia and India. It has already established a set of institutional engagements with East Asia's subregions, each of its major players, as well as its regional organisations including ASEAN, through FTA negotiations. It hopes that this will be part of a regional effort that leads to a trade area for goods, services and investment³⁴ that covers all major Asian economies and possibly extends to Australia and New Zealand.³⁵

Institutional infrastructure built through the FTAs could lead to the eventual formation of an Asian economic community, which India's Prime Minister Manmohan Singh is strongly promoting.³⁶ In his view, an economic community consisting of India, China, Japan, South Korea and ASEAN would include nearly half the world's population and have an economy larger than the European Union's in terms of income and bigger than North America free trade area in terms of trade.³⁷ With the launch of the East Asia Summit, India accepted ASEAN+6 as the embodiment of the emerging Asian economic community. And India's participation adds significantly to its ever-increasing weight in an evolving global balance.³⁸

India believes that different interests could be better balanced within ASEAN+6, as opposed to ASEAN+3 (ASEAN member countries plus China, Japan and South Korea) where a dominant country would arise. In terms of priority of relations in an Asian economic community, India's point of view is that ASEAN should be at the core, followed by China, and then by Australia and Japan.³⁹ Currently, the Asia Pacific Economic Cooperation (APEC) is seen as too loose an organisation to be effective. This view may well change if India is approached to become an APEC member

Impacts of India Looking East

Since 1991 the LEP has been a consistent Indian government policy, despite several changes in the ruling parties forming the government. It was initiated by the government led by Rao's Congress Party and pursued by the BJP-led government under PM Vajpayee during the late 1990s and early 2000s. Since 2004 the LEP has been strongly backed by the Congress-led coalition government. The extensive institutional links between India and East Asia would not have been established had India not vigorously pursued the LEP.

The business sectors in both India and East Asia are taking advantage of India's strong growth, reforms and liberalisation to further their activities. The economies of

India and East Asia are generally regarded as complementary, with India's advantage in software and service industries complementing East Asia's strength in manufacturing. This complementarity underpins the strong push by government for closer bilateral economic cooperation, exemplified by the construction of institutional and economic frameworks at the bilateral, subregional and regional levels.

The extent to which the LEP has achieved its objectives, as well as its influence on Asian economic integration, are considered in this section.

East Asia Becoming More Important to India

The LEP has transformed India's external relations since 1991. The rapid growth in India's economic relations with East Asia has resulted in the region becoming more important in India's overall international economic relations, greatly affecting its economic growth, reform and development.

New Sources of Growth

International trade of goods and services is now a strong driver of India's growth, rising from 17 per cent of gross domestic product in 1991 to 42 per cent in 2004.⁴⁰ And East Asia accounted for a significant part of the rise in India's foreign trade.

India's trade with East Asia was less than 10 per cent of India's international trade in the early 1990s. It is now 25 per cent. In 2005, trade with China grew by nearly 80 per cent, with South Korea by close to 50 per cent, with Japan by nearly 20 per cent and with ASEAN by 13 per cent. East Asia is now India's major trading region, having overtaken the European Union and North America, traditionally two of India's largest trading regions (table 1).

TABLE 1 INDIA'S TRADE WITH EAST ASIA AND THE REST OF THE WORLD, 2004

	Export	Import	Total
	%	%	%
United States	7.63	15.18	11.98
China ^a	7.43	7.09	7.24
ASEAN	11.78	5.04	7.90
Japan	3.81	2.41	3.01
South Korea	4.55	1.71	2.91
East Asia	30.45	19.73	24.28
European Union	25.16	18.53	21.34
Australia	0.86	3.28	2.25
Rest of the world	35.90	43.27	40.14

^a Hong Kong is not included in China. Hong Kong's inclusion would push China's share to above 12 per cent of India's total exports in 2004.

Source: United Nations Comtrade database.

The United States is still India's biggest bilateral trading partner, followed by China. Yet the different growth momentum in the India–China trade and the India–US trade means that in a year or two China will be India's largest trading partner. As a result, India has increasingly seen East Asia as an important source of growth. The New Foreign Trade Policy, announced in August 2005, sets a target to more than double India's current share of total global trade to 2 per cent by 2009. India's economic integration with East Asia is seen as critical to achieving this target.⁴¹ When addressing the ASEAN business summit in 2003, former Prime Minister Vajpayee set a target for annual India–ASEAN trade of US\$30 billion by 2007, up from US\$12.5 billion in 2002.

Impacts on Economic Reform and Liberalisation

East Asia's economic success has inspired India's reforms and shaped its thinking on economic liberalisation. As India's Prime Minister recalled in 2006:

When we first set the target of bringing India's tariffs down to 'ASEAN levels', it was not just an exercise in tariff liberalisation but an attempt to benchmark our economic performance against some of the best performers in our neighbourhood.⁴²

India's effort to improve its investment regime to encourage more foreign investment has also been referenced to the reform and practices undertaken in East Asian economies.

The path of reform and liberalisation in India has been heavily influenced by the issues, agendas and outcomes of its FTA negotiations. Some of the steps taken in domestic reform are a direct consequence of external negotiations. For instance, India's financial sector, especially its banks, is controlled by the Reserve Bank of India, which tightly restricts foreign entry. While the benefit of liberalisation is generally understood, the Indian Government is unwilling to liberalise the financial sector unilaterally. It would rather use the sector as a bargaining chip in international negotiations and make concessions only as a result of bargaining. In the negotiations on the Comprehensive Economic Cooperation Agreement with Singapore, India granted Singaporean banks national treatment. This was seen in India as a hefty price worth paying in return for Indian banks gaining access to ASEAN member countries through the backdoor of Singapore.⁴³ However, the banking sector is unlikely to open fully to foreign competition in the near future.

Impacts on India's Subregional Development Strategies

Relying on East Asia's growth has also shaped India's regional development strategy. The rise of China has figured prominently in the minds of India's policymakers recently. This has not only led to India seeing new opportunities for promoting broad-based development, but also implied that some of its strategies either needed to be changed or dropped. For instance, China's desire to develop its south-west matches nicely India's policy to develop its north-east, leading to bilateral proposals to develop a subregional growth triangle. There are already direct road links between India and China through Sikkim. A highway funded through the Asian Development Bank is being constructed and will enhance the growth triangle.⁴⁴ China's entry into the Bangkok Agreement in 2001 injected new dynamism into the oldest preferential trade agreement between Asian developing countries. The Bangkok Agreement provides a platform for interactions between China and India on subregional development issues.⁴⁵ On the other hand, BIMSTEC and the Mekong–Ganga Cooperation face difficulties, partly due to the exclusion of China, which is now seen as a strong growth engine. The

two initiatives now hold less promise, particularly the Mekong–Ganga Cooperation, which has been dormant for a long while because of a lack of interest and funding.

India Shaping the Formation of an Asian Economic Community

India's economic integration with East Asia is influencing the shape of an eventual Asian economic community.

East Asia Embracing India

There were 'few buyers of the India story' when the country was growing slowly. Now East Asia looks at India more favourably due to many factors, the most important being the country's emerging status as an economic superpower. With a large population, a growing middle class and a huge consumer market, East Asia considers India to have enormous growth potential and business opportunities. India's economic rise offers many East Asian economies an opportunity to diversify risk by reducing their dependence on China's growth.⁴⁶

India's proactive approach to engaging with East Asia has also sent strong signals that India is an important force in building an Asian economic community. Economic integration within East Asia accelerated in the wake of the devastating Asian financial crisis. India opened up more import channels to ASEAN member countries during the crisis, paving the way for closer ties between the ASEAN group and India and for greater bilateral economic cooperation.

There is strong political backing in ASEAN for closer economic ties with India. Political leaders, such as Thailand's Thaksin, have strongly pushed for closer economic links with India through an FTA.⁴⁷ When some technical difference stopped ASEAN trade officials from negotiating with India on an FTA for a few months, ASEAN leaders stepped in and decided at the summit meeting in November 2005 to resume the talks.⁴⁸ Some ASEAN member countries have adopted a policy of 'Look West' to match India's LEP. ASEAN and India have many areas of common interest, including information and communication technologies, public health, medicine, trade, investment and agriculture.⁴⁹ Cooperation with India is expected to bring significant economic benefits to ASEAN.⁵⁰

ASEAN and Indian leaders signed a 'partnership for peace, progress and shared prosperity' at the third ASEAN–India summit in 2003. The partnership is an

overarching framework for the bilateral relations. A plan for action was subsequently adopted for many areas, including trade, investment, information and communication technologies, human resources and transportation.⁵¹ The plan encourages private sector participation leading to ASEAN–India business summits, trade fairs and missions. ASEAN also invited India to help Cambodia, Laos, Burma and Vietnam to develop capacity building, English training, small and medium enterprises, ICT training, and software.

More broadly, India and East Asia have found that their mutual economic and commercial interests are based solidly on the complementarity in their trade and economic and demographic structures.

- > India's sectoral strengths appeal to East Asia, which is looking for trade and investment opportunities in the services sector. East Asia has found India strong in information technology, services, construction, fishery, food processing, resources, capital, technology, manpower, knowledge and tourism.
- > Many East Asian economies, including Singapore, Malaysia and China, have excessive savings and find investment opportunities in India promising.
- > India's abundant young and skilled labour force is an important, internationally competitive, mobile counterpoint to East Asia's ageing societies.

East Asia is taking a proactive approach to the business opportunities in India's reforming economy. There is also a strong view in India that, at least until very recently, firms from East Asia have tended to be less risk averse than western firms in trading with or investing in India.

India Shaping the Formation of the ASEAN Economic Community

The rise of India has injected new dynamism into and is shaping the process of East Asia's economic integration. The impact of this on ASEAN is clear. Along with the rise of China, the rise of India has put pressure on ASEAN economies to remain competitive in business, trade and investment, as well as to stay in the driving seat for regional economic integration. As a result, ASEAN has accelerated the economic integration of its member countries. The ASEAN Free Trade Area and the goal of building an ASEAN economic community by 2010 are efforts to achieve better productivity, economies of scale, and competitiveness.⁵²

FTA negotiations with India have directly led ASEAN to build up internal capacity for coordination and negotiation. ASEAN has a co-chair for negotiations with India. Member countries share their experiences in the negotiations with each other. When Malaysia acted as ASEAN's coordinator, it worked with India on the feasibility study of an ASEAN–India FTA, investigating how India could be linked with the ASEAN Free Trade Area.⁵³ ASEAN formed an ASEAN–India economic linkage task force, which recommended FTA issues to ASEAN economic ministers, looked at recommendations, and prepared a framework agreement on comprehensive economic cooperation between ASEAN and India.⁵⁴

The FTA negotiations between India and ASEAN were first undertaken by trade officials at a bilateral level, moving up to senior officials and ministers, before reaching leaders. This exercise helped ASEAN members better understand each other and ASEAN's internal process.⁵⁵ The bilateral mechanisms and the people-to-people contact of the negotiations also assisted ASEAN and India understand each other better. The mechanisms included joint committee meetings, director-general meetings, senior official meetings and ASEAN–India ministerial meetings. At the bilateral level between India and Thailand, for instance, there are Thai–Indian working groups as well as senior ministerial meetings. Through rounds of FTA negotiations, Thai and Indian government officials have become more familiar with the approaches and tactics adopted by one another. The personal relations and trust built up in the process have facilitated the negotiations.⁵⁶

India Shaping the Emerging Asian Economic Community

In moving toward an Asian economic community, ASEAN sees the risk of being marginalised by China, India and Japan, whose economic weights make them dominant players. However, ASEAN also sees India's involvement as an opportunity to balance the influence of either China or Japan, and help ASEAN remain in the driver's seat. This consideration led ASEAN to strongly support the invitation of India to be one of the 16 inaugural members of the first East Asia Summit held in Kuala Lumpur in December 2005. The East Asia Summit is widely seen as the formalisation of the nascent Asian economic community.

Compared with ASEAN's enthusiasm, China and Japan were initially ambivalent about India's inclusion in the summit. They understood the economic merit

of India's engagement. They could also see that India's involvement would benefit the region more in the long term than in the immediate future, as India's current level of economic integration with East Asia is low. The views of China and Japan began to diverge when each assessed more closely the political benefit of India's involvement. Wary of China's potential dominance, Japan welcomed India's involvement. China warmed to India's membership when a two-tiered system was designed by ASEAN to temporarily make ASEAN+3 the core group within the summit, leaving the outsiders – India, Australia and New Zealand – in the other tier. The two-tiered system also suited ASEAN at the time, which ranks China ahead of India, and India ahead of Japan in importance. The balance of different interests among China, Japan, and India can help ASEAN stay at the centre of the process.

India sees its membership of the East Asia Summit as an important step towards realising its grand strategic goals for regional cooperation. India believes that the summit is a sensible decision-making forum for regional issues. With an annual meeting and open, transparent and inclusive processes, the East Asia Summit can be the forum for building the Asian economic community.⁵⁷

India appreciates the role of ASEAN in bringing together the summit members. Yet it believes that it, like other countries with greater economic weight, should have a more important role to play.⁵⁸ It also believes that the core group within the summit will find the summit processes difficult as long as the rivalry between China and Japan remains. Because the groups of countries in the East Asia Summit or JACIK should make Japan and China less fearful of the other's dominance, some Indian commentators have argued that ASEAN+6 or JACIK would be a better option for building the Asian economic community as no one country would be able to dominate.⁵⁹

Obstacles to India – East Asia Economic Integration

Despite India's influence in shaping Asia's economic integration, there are obstacles to India's integration with East Asia.

First of all, India currently has **limited economic integration** with East Asia. India has yet to become a significant market for most East Asian economies. For instance, it accounts for less than 1 per cent of Thailand's international trade⁶⁰ and 2.5 per cent of Singapore's international trade in 2004⁶¹. Talk of India's economic influence on East Asia is based more on an extrapolation of its current rapid growth

than a reality. To make it a reality India needs to continue its domestic reform (discussed earlier).

Inefficient bureaucratic processes are perceived to limit India's commitment to engage with East Asia. Despite Indian leaders proposing an open sky policy, ASEAN found that its bureaucrats have yet to implement it wholeheartedly, as Indian negotiators preferred a commercial deal, involving reciprocity from ASEAN member countries. India also put up conditions for the policy's implementation, including a long adjustment period for India.⁶² ASEAN also feels confused by India's political system of central and state governments that often give different interpretations to trade agreements.

Different economic structures and degrees of openness have affected the approaches taken by East Asia and India in their economic engagement. ASEAN economies are more open, relying heavily on imports of raw materials and capital as production inputs, while the Indian economy relies more on domestic inputs.⁶³ Mounting pressure from India's business sector for protection has also tied the hands of Indian trade negotiators. In the FTA negotiations between India and ASEAN, the rules of origin and the negative list have become sticking points. India was much stricter on rules of origin, insisting on 40 per cent local content in exports.⁶⁴ India's trade negotiators used rules of origin as a protective instrument.⁶⁵ India's initial negative list included 1414 items of sensitive products that it wished to exclude from the FTA negotiations. ASEAN proposed only 40 items.⁶⁶

Related to the above difficulties is the **image problem** that some ASEAN countries believe India has. In particular, Indian traders are perceived to be ticklish to deal with and its trade negotiators too tough. These images are not necessarily accurate, but they affect decision-making. For instance, Thailand thinks it is difficult to project its long-term economic relations with India, while India feels ASEAN is a lot closer to China than to India in terms of cultural affinity, managerial style and business operation. ASEAN businesses perceive entry barriers to India to be higher than those to China.⁶⁷

To date, **foreign direct investment** has not played as significant a role in India's economic development as it has in China's. East Asia has been an important source of such investment in China, which has fuelled its economic growth and manufacturing exports. India's policy on foreign direct investment has been restrictive and such

investment to India tends to be concentrated in the service and IT sectors, which are often less capital intensive than the manufacturing sector.

Many of these obstacles appear to be transitional. Perception can change as two parties get to know each other. This has certainly been the case between India and East Asian countries. Greater familiarity with each other's business practices and political systems will help to lower the barriers to entry, some of which initially appear to be unsurmountable. On the issue of honouring trade agreements, ASEAN now has insisted that any FTA signed with India should commit both its central government and its state governments.⁶⁸ India has accepted this, although the effectiveness of its commitment is not yet tested and is questionable, given the complex relationship between the central government and the state governments in India.

On the other hand, despite two years of negotiations, Thailand and India have reached agreements on the rule-of-origin issue, with compromises made by both sides. Although the long negative list insisted on by India still presents as a problem, it was trimmed in the negotiation process. It becomes increasingly likely that India and ASEAN will finally sign the FTA at the next India–ASEAN summit in November 2006.⁶⁹

Concluding Remarks

Economic reforms and liberalisation since 1991 have underpinned India's high growth rates, rapidly expanding domestic market, and rising international competitiveness in services, information technology and a range of manufacturing products. India's rapid growth has escalated its demand for imported resources, energy, technology, consumer products, as well as new export markets. The LEP has facilitated East Asia's rising share of India's international trade and made the region more important to India's growth. By looking east, India has significantly strengthened institutional ties with East Asia and made itself a 'member' of the emerging Asian economic community. Having examined the LEP by exploring its links with India's reforms, growth prospects and integration with East Asia, three general observations can be made.

First, India has used the LEP to support economic reforms and liberalisation, sustain its rapid growth, facilitate its economic integration with East Asia, and promote equity-based domestic development. While initially used to send a strong signal to the

world of India's economic liberalisation, the LEP has increasingly become a vehicle to push for India's participation in Asia's economic integration.

Second, India has built up strong institutional links with East Asia through a web of engagements at bilateral, subregional and regional levels. While Singapore and Thailand facilitated India's initial engagement with ASEAN in the 1990s, ASEAN facilitated India's engagement with the whole East Asia in the early 2000s. India has now developed a more balanced relationship with each of East Asia's economic powers – namely, ASEAN, China, Japan and South Korea.

Third, India has become an influential member of Asia's nascent economic community, and has used its influence to shape agendas for Asia's economic integration. India's potential as an economic superpower has already made it an equal partner of ASEAN, China, Japan and South Korea. It is pushing for a region-wide FTA that will cover trade in goods and services as well as investment arrangements. It used the concept of JACIK (ASEAN+4) to push for India's inclusion in the East Asia Summit. Since it became an inaugural member of the summit, it has deemed ASEAN+6 as the membership formula for Asia's nascent economic community. Being part of the Asian economic community is expected to provide India not only with a hedge in an increasingly fragmented world trading environment, but also with a platform from which to become a global economic superpower.

Based on these observations, what does the future hold for the LEP and India's economic relations with East Asia?

India and East Asian countries are likely to continue to deepen their economic integration because their rapidly growing economies will demand more imports and exports, boding well for the expansion of bilateral trade. East Asia will continue to be India's external source of growth, and the Indian economy will become more important to East Asia. India's LEP and institutional foundation laid in supporting economic engagement will continue to reinforce this trend.

Yet, to accelerate the pace of its economic integration with East Asia, India needs to overcome institutional obstacles and improve its investment climate, which will be targeted during India's next stage of reform and liberalisation. This change will include opening its market wider to competition, revamping its rigid labour laws, and transforming the role of its government to provide better services to markets and society.

Successful reform within India will significantly affect its economic relations with East Asia. While the Indian economy generally complements the economies in East Asia, India's future reforms may change this, particularly its trade complementarity with the developing ASEAN economies and China. Much of developing East Asia's competitive advantage in manufacturing is a result of India not having liberalised its labour market, which consequently ties its abundant cheap labour to an inefficient agricultural sector. Serious labour market reform could lead India to developing a greater manufacturing sector.

Such an expansion may result in a greater competition with China and ASEAN member countries, producing two positive impacts. First, India may attract more manufacturing-oriented direct investment from East Asia. This would integrate India into part of East Asia's production and supply networks that currently elude India. Second, India's continuing economic liberalisation would encourage East Asian countries to reform and adjust their policies to make their businesses more competitive. In other words, India's reform would trigger a new round of economic reform and liberalisation in East Asia. Both impacts would help economic integration between India and East Asia.

India is a potential economic superpower. Any assessment of its LEP would not be complete without placing it in a broader regional and global context. Although the assessment of the LEP presented in this paper has been limited almost exclusively to India and East Asia, India's economic relations with the rest of the world have significant bearings on its East Asia economic policy. However, a broader consideration of external factors would not alter, but rather reinforce, the argument for deepening the economic integration of India and East Asia.

This would be the case if India's economic relationships with its South Asian neighbours were taken into account. India has been a member of the South Asia Association for Regional Cooperation since it was established in 1985. The India–Pakistan animosity has prevented SAARC from playing a role that ASEAN has played in South-East Asia. However, a recent (January 2006) quiet achievement of SAARC was the creation of the South Asian Free Trade Area (SAFTA), which aims to increase the economic integration of member countries.⁷⁰

While SAFTA should give some boost to the very low level of intraregional trade in South Asia, smaller regional countries would benefit more from it than the Indian

economy, which is about 80 per cent of the South Asian economy. India's main interest is in using SAFTA to foster good political relations within SAARC. When seeking external growth engines, India will continue to look east, and so will all other SAARC members. India will also find allies among SAARC member countries when dealing with East Asia, as it has already done so. Thailand, for instance, found that the small SAARC countries took a similar stand in the negotiations for the BIMSTEC FTA.

Of more importance is the future direction of India's economic relationships with the United States and the European Union. Although their shares of India's international trade have declined, the United States and the European Union are still considered critical to the Indian economy, particularly because off-shoring of IT and services by US and EU firms has driven the rise in India's exports of services and information technology. India also relies on the EU and US markets in its knowledge-based sectors where more advanced technologies are used. While India's service and IT sectors remain strong the Indian and East Asian economies will continue to be complementary — somewhat diluting the possibility of India competing with East Asia in manufacturing, which was discussed earlier. However, if India were to face a shortage of software engineers and skyrocketing wages in the services sector, India may well be forced to tackle the obstacles that prevent expansion in its manufacturing sector. As discussed previously, this would lead to greater economic integration with a manufacturing in East Asia.

All of the above scenarios imply that India will continue to deepen its economic integration with East Asia

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Notes:

¹ Unless otherwise specified, East Asia in this paper refers to the ten South-East Asian countries that are members of the Association of Southeast Asian Nations – the ASEAN-5 (Indonesia, Malaysia, the Philippines, Singapore and Thailand), Brunei, Burma (Myanmar), Cambodia, Laos and Vietnam – as well as China, Japan and South Korea from the north-east.

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⁴ V Kelkar, 'India's economic future: moving beyond state capitalism', paper presented to the DR Gadgil memorial lecture, New Delhi, 26 October 2005.

⁵ *The Economist*, 'Can India fly?', 3 June 2006, p. 11.

⁶ Asian Development Bank, 'From the Hindu rate of growth to 10%: what will it take?', *Asian Development Outlook 2006*, ADB, Manilla, 2006, pp. 165–6.

⁷ S Rangnekar and M Sharma, 'India's split personality', *Far Eastern Economic Review*, vol. 169, no. 1, 2006, pp. 18–21.

⁸ *The Economist*, 'Few hands make work light', in *A Survey of Business in India*, 3 June 2006, pp. 8–10.

⁹ Interviews with Dr Ashish Narain, Economist, World Bank, New Delhi. Also, see Rangnekar and Sharma.

¹⁰ Interviews with Professor Mukul G Asher, Lee Kuan Yew School of Public Policy, National University of Singapore.

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¹⁵ S. Kumara, 'Burma visit highlights India's "Look East" strategy', 6 April 2005

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¹⁶ Interviews with Narain.

¹⁷ Interview with Dr Saumitra Chaudhuri, Economic Adviser and Research Coordinator, ICRA Limited (Investment Information & Credit Rating Agency), New Delhi.

¹⁸ S. Ramchandran, 'India should aim at becoming part of Asian economic community', *The Hindu*, 9 April 2006 <http://www.hinduonnet.com/thehindu/thscrip/print.pl?file=20060409001700.htm&d>.

¹⁹ *VOA News*, 'India promotes India of free trade within East, South Asia', 23 October 2004

<http://www.asianresearch.org/articles/2383.html>.

²⁰ Interview with Dr Sanjib Pohit, Principal Economist, NCAER, New Delhi.

²¹ Interview with Dr Nagesh Kumar, Director-General, Research and Information System for Developing Countries, New Delhi.

²² M Singh, 'PM's address at the inauguration of New Capital Complex of Assam', Dispur, 21 November 2004 <http://pmindia.nic.in/speech/content.asp?id=48>.

²³ Rangnekar and Sharma.

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- ²⁴Interviews with Pohit and Chaudhuri. Also, see N. Deva, *India's Look East Policy*, Roll no. 100, Jaipuria Institute of Management, 1 March 2006
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- ²⁵Interviews with Associate Professor Sothitorn Mallikamas, Dean, Faculty of Economics, and with Professor Somchai Ratanakomut, Faculty of Economics, Chulalongkorn University, Bangkok, Thailand.
- ²⁶Interview with Kumar.
- ²⁷Interview with Narain.
- ²⁸*Financial Express*, 'India for pan-Asian trade agreement', 28 January 2006
http://www.bilaterals.org/article-print.php3?id_article=3682.
- ²⁹Interview with Ms Saithong Soipheth, Department Trade Negotiations, Ministry of Commerce, Thailand.
- ³⁰Interviews with various sources in Thailand.
- ³¹SAARC member countries are Bangladesh, India, Pakistan, Maldives, Sri Lanka, Nepal and Bhutan.
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- ³³Interview with Saithong.
- ³⁴*Financial Express*.
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- ³⁷*VOA News*, 'India promotes India of free trade within East, South Asia', 23 October 2004
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- ⁴⁶Interviews with Mr Nopporn Adchariyavanich, Director, Department of ASEAN Affairs, Ministry of Foreign Affairs, Thailand, with Professor Mukul G Asher, Lee Kuan Yew School of Public Policy, National University of Singapore, and with Ms Narinthip Homwisetwongsa, Bureau of East Asia, Department of Trade Negotiations, Ministry of Commerce, Thailand.
- ⁴⁷Interviews with Sothitorn and Somchai.
- ⁴⁸Interview with Saithong.
- ⁴⁹Interviews with Sothitorn, Somchai, Saithong and Nopporn.
- ⁵⁰Interviews with Nopporn and Asher.
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- ⁵²Economic Analytical Unit, 'ASEAN: building an economic community', Department of Foreign Affairs and Trade, Canberra, 2006.
- ⁵³Interview with Narinthip.
- ⁵⁴Interview with Narinthip.
- ⁵⁵Interview with Saithong.
- ⁵⁶Interviews with Sothitorn and Somchai.
- ⁵⁷Interview with Kumar.
- ⁵⁸Interview with Kumar.
- ⁵⁹Interview with Kumar.
- ⁶⁰Interviews with Sothitorn and Somchai.
- ⁶¹Calculation based on Asian Development Bank data
http://www.adb.org/Documents/Books/Key_Indicators/2005.

⁶²Interview with Nopporn, who was a key ASEAN negotiator.

⁶³Interviews with Sothitorn and Somchai.

⁶⁴Interviews with Sothitorn and Somchai.

⁶⁵Interview with Saithong.

⁶⁶Interview with Nopporn.

⁶⁷Interview with Narain.

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