

TRADING TENSIONS AWAY

Regional economic integration and geopolitics

foreign secretary Mrs Nirupama Rao (previously an ambassador to China and current Ambassador to the US) noted that between 2005 and 2010, Prime Minister Manmohan Singh and Premier Wen Jiabao had met no less than 11 times. Following Premier Wen's official visit to New Delhi in December 2010, the two sides agreed to institute a strategic bilateral economic dialogue, the first meeting of which will take place in late September this year.

The issue is whether any of these tensions could be better eased through participation in plurilateral groupings rather than purely bilaterally, and, if so, what such a grouping might look like. At the global level, India and China are leading emerging-market members of the G20 and have coordinated their positions in areas such as the multilateral trading system, reform of the international financial institutions and climate change finance. The competitive issues are likely to be sharper within Asia, where India has valid concerns of being marginalised by Chinese trade and finance in a dynamic region of historic, cultural and strategic interest to it.

These issues of regional economic architecture are yet to receive sustained attention within the Indian establishment. Much will depend on how an expanded East Asia Summit, now to include Russia and the US, begins to function on security issues, and on whether that expanded EAS generates any economic coordination mechanism similar to that provided by ASEAN+3. In my view, India should embrace the EAS process vigorously as a way of complementing bilateral contacts with China that span economic and security issues. Whether this would also be the Chinese preference remains to be seen.



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EAST Asia's pursuit of policy strategies of openness to trade and investment have resulted in its being economically one of the world's most internationally-integrated regions — both intraregionally and towards the rest of the world. South Asia, on the other hand, is one of the world's least integrated regions and, measured in terms of intraregional trade as a share of total trade, is the region with the lowest integration globally. Intraregional trade in South Asia was 3.5 per cent of total South Asian trade in 2009, up from a low of 2 per cent in 1967 but significantly lower than the 19 per cent in 1948. Intraregional trade in East Asia was 40 per cent in 2009.

The differences in regional economic integration mean that the effect of political tensions between countries on trade is more pronounced for South Asia than it is in East Asia.

Trading partnerships between open economies are determined by comparative advantage and market forces, and the advantages of proximity are also important. A region with low economic integration is likely to be losing out on the benefits that flow from trade due to economic proximity. But additionally, because political interactions tend to occur much more frequently between neighbours, higher economic interdependence

can ameliorate the adverse effects of political tensions that may arise between neighbouring countries.

Political tensions can, of course, act as a barrier to economic integration; and lack of economic integration and interdependence can constrain improving political relations. The relationship between India and Pakistan is an obvious example of the latter. The East Asian case is very different, where the region's economies enjoy high levels of trade and economic integration, despite unresolved historical issues and long-standing political mistrust in some of the region's bilateral relationships.

Political tensions between Japan and China from 2001 to 2006, for example, rose to a level where leadership visits between the two countries were suspended and there were large protests in China against Japan and boycotts aimed at Japanese goods. Yet these political tensions did not derail economic relations, nor significantly affect the continued growth of Sino-Japanese trade. The start of this period of political tension coincided with China's accession to the World Trade Organisation (WTO) in December 2001.

It was not simply the increased trade and positive news from China joining the WTO that offset the conflict and tension between Japan and China. But it was China's commitment to the global trading system after



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1986, with rapid trade liberalisation and economic reform, that gave Japanese firms confidence in dealing with Chinese counterparts. China steadily adopted, and constrained itself to, global trading rules and norms through its 15-year accession march towards membership of the GATT and later the WTO. The experience of the Japan-China relationship shows the importance of countries' integrating into the global economy and being part of the global trading system for bilateral relationships to prosper.

The experience of the cross-Straits (China-Taiwan) relationship highlights the importance of intraregional economic integration in improving bilateral economic relations. Political relations between Beijing and Taipei have been even more difficult than Japan-China relations. Taiwan had

banned imports from China up until the early 1990s for political reasons. In the 1990s, these bans were lifted gradually, and then more rapidly after both China's and Taiwan's accession to the WTO in 2001. Taiwan and China have become increasingly integrated into the complex production networks in East Asia. As their economies' integration into the regional economy deepened, indirect interdependence increased and the indirect as well as the direct costs of Taiwan's discrimination against mainland Chinese imports became more apparent. The trading relationship is now more 'normal' despite the residual trade bans that are still in place. Deep integration into the regional economy has carried the bilateral Taiwan-China economic relationship beyond being simply bilateral in nature.

In contrast, the non-integrating East Asian economies of North Korea and Myanmar are important examples of closed economies whose bilateral relations with their neighbours and beyond are dominated by political conflict.

Unlike Taiwan-China relations, where impediments to trade were reduced over time as the regional economy became more integrated around them, the under-development of South Asian economic integration and interdependence means there is less incentive to reduce barriers to trade or improve poor infrastructure, lift bans on investment and ease people movement across borders.

Pakistan is yet to reciprocate most favoured nation (MFN) status in trade with India and maintains a narrow positive list (786 items) of goods that India may export to Pakistan. At the same time, India's tariff rates remain high, especially for goods of particular interest to Pakistan, such as textiles, leather and onyx, and non-tariff barriers are substantial. The relationship between India and Pakistan is not nested in robust regional cooperation, so bilateral economic dealings are swamped by bilateral political dealings and negative-sum or zero-sum security issues.

East Asia's experience suggests that bilateral economic relations nested in a highly integrated region that is outward-looking and globally oriented helps to dampen, and even reverse, the effects of political conflict on trade. Thus political problems that limit economic integration in South Asia are likely to become more tractable if the whole region is tied more closely into positive trade and economic relations, trans-regionally and globally, and committed to full observance of the global rules of trade. **EAFO**