

**Round Table Session 1,
The Indian Ocean Economy: The New Global Growth Pole¹**

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1. Measuring the Indian Ocean Economy

Despite its importance in international relations and international law, the macroeconomic significance of the Indian Ocean remains below the radar. This is partly the result of the units of analysis that are generally employed by macroeconomic studies and the novelty of research on Asia-Africa economic integration.

While the International Monetary Fund (IMF), the World Bank, the United Nations and others provide regular country and regional macroeconomic analysis, this has been confined to more traditional geographic groupings typically based on shared land borders.² As such, there is an absence of literature on the historic performance and short-term outlook of Indian Ocean littoral states as a grouping or accounting for the importance of economic links between its diverse economies.

When looked at as a single unit, the 28 states of the Indian Ocean have a substantial weight in the global economy. This includes Australia, Bangladesh, Brunei Darussalam, Cambodia, Comoros, India, Indonesia, Iran (Islamic Republic of), Kenya, Madagascar, Malaysia, Maldives, Mauritius, Mozambique, Myanmar, Oman, Pakistan, Seychelles, Singapore, Somalia, South Africa, Sri Lanka, Timor-Leste, Thailand, United Arab Emirates, United Republic of Tanzania, Viet Nam and Yemen. In 2017, these economies were home to 35.0% of the world's total population (2.6 billion people), and accounted for 15.7% of world trade (USD 5.9 trillion) and 18.5% of global GDP (at PPP exchange rates). For analytical convenience, the region can be divided into three geographical sub-regions that are significant in their own right: Africa and the Middle-East, South Asia, and East Asia and the Pacific (see Table A1).

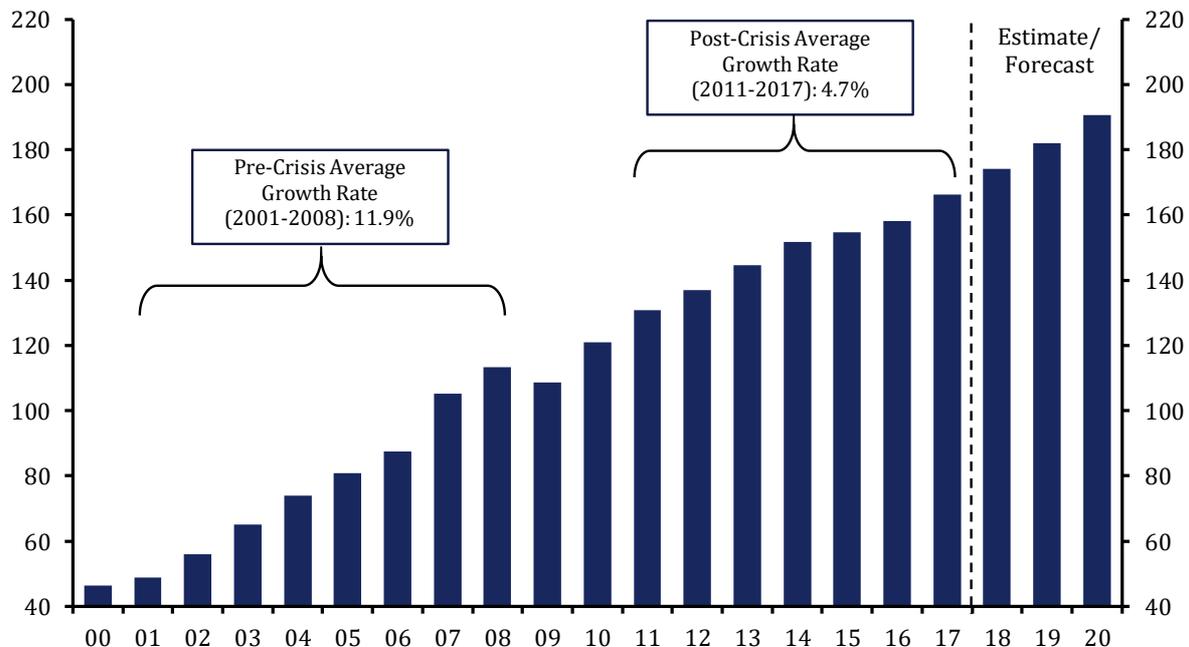
¹ Background paper prepared by the Lakshman Kadirgamar Institute of International Relations and Strategic Studies (LKI), Sri Lanka.

² For example, the IMF produces a bi-annual World Economic Outlook report as well as several Regional Economic Outlook reports, including for the Asia-Pacific, Sub-Saharan Africa, the Middle East and Central Asia. IMF (2018a), *World Economic Outlook 2018*, International Monetary Fund: Washington DC. IMF (2018b) *Regional Economic Outlook 2018: Sub-Saharan Africa*, International Monetary Fund: Washington DC.

2. Maritime Trade Led Growth

Maritime trade has fundamentally shaped the Indian Ocean economy throughout history, but this has been especially true since the turn of the 21st century.³ This rise has been propelled by the strategic location it holds among global shipping lanes and the relatively low costs of shipping as a means of transporting goods internationally.

Figure 1: Indian Ocean Container Port Traffic* (Million TEUs)



Sources: LKI calculations based on UNCTAD, Maritime Transport Database, Available at: <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx>, Accessed on August 2018

*2018-2020 data are based on the continuation of post-crisis average growth rate.

Today, the Indian Ocean hosts 23 of the world's top 100 container ports.⁴ Container traffic through its ports has increased fourfold from 46 million TEUs in 2000 to 166 million TEUs in 2017, and is on course to reach over 190 million TEUs by 2020 (see Figure 1). Within the Indian Ocean, East Asian and Pacific ports dominate container traffic, accounting for 63.0% total regional container traffic in 2017. Overall Indian Ocean container traffic was equivalent to 22.0% of global container traffic in 2017. Meanwhile, China accounted for 28.4% of global container shipping, the US for 6.8%, Japan for 2.9% and Germany for 2.8%.

Reflecting the expansion of maritime trade in the Indian Ocean, regional trade growth has outperformed the world economy since 2000. Trade volumes in the Indian Ocean grew by an annual average of 9.4% from 2000 to 2008 and, while growth settled at a slower average of 4.8% from 2011 to 2017 after the global financial crisis, this compares with 6.9% and 3.9% for world trade volume growth over the same periods. In terms of trading partners, China

³ See Pandya, A., R. Hebert-Burns and J. Kobayashi (2011), *Maritime Commerce and Security: The Indian Ocean*, Washington DC: The Henry L. Stimson Center, Washington D.C.

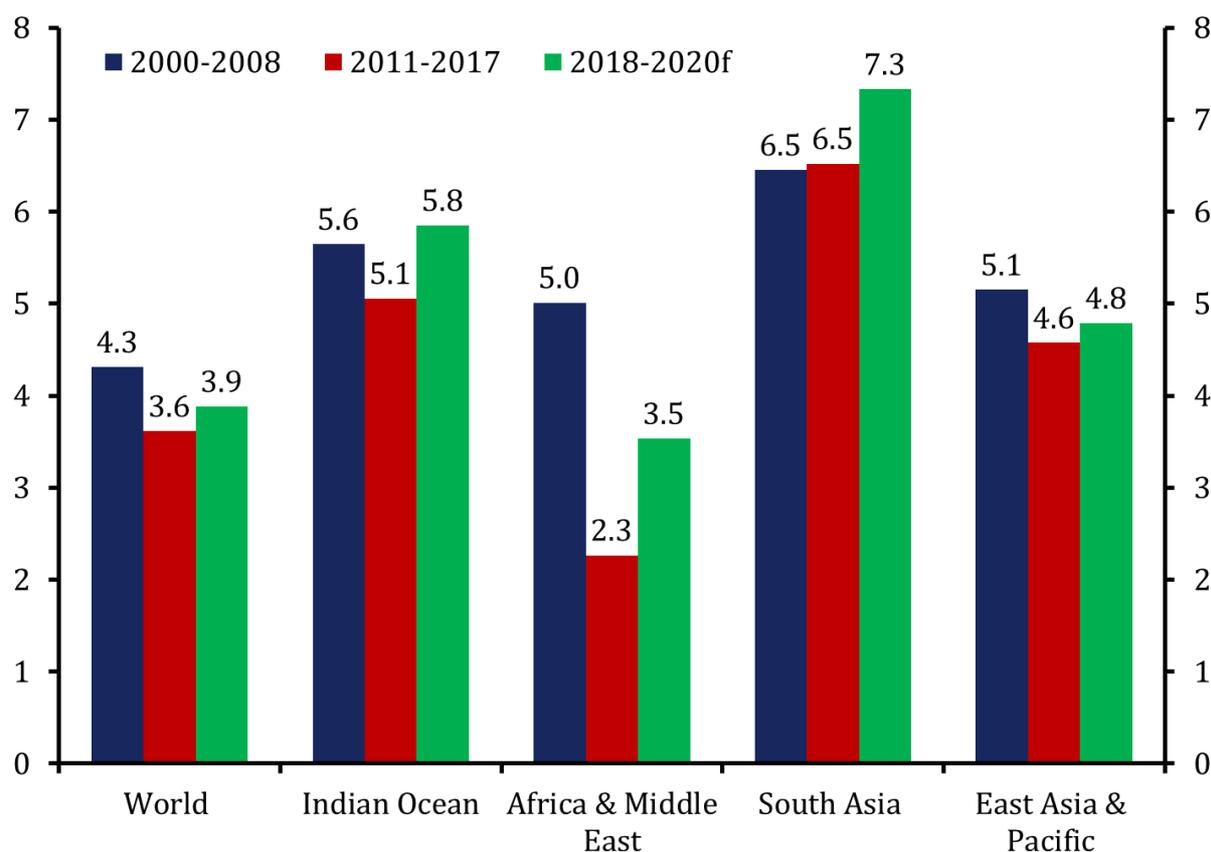
https://www.stimson.org/sites/default/files/file-attachments/Section_1_-_Maritime_Commerce_and_Security_The_Indian_Ocean_1.pdf

⁴ According to the 2017 Lloyd's List Top 100 Container Ports Rankings.

accounted for 16.1% of the Indian Ocean’s total goods trade in 2017, while the EU had 12.0%, the US 7.9% and Japan 6.5%. But intra-regional trade is also substantial, accounting for 27.2% of the region’s trade.

Similarly, regional GDP growth was less affected by the crisis than world growth. The Indian Ocean economy grew at 5.6% per year during 2000-2008 and slowed slightly to 5.1% in 2011-2017, led by a strong performance in South Asia (see Figure 2). Meanwhile, world growth slipped from 4.3% to just 3.6% in the two sub-periods.

Figure 2: Indian Ocean Economy and Sub-Regional Real GDP Growth (% y/y)



Sources: LKI calculations based on IMF, World Economic Outlook Database, Available at: <http://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx>, Accessed on June 2018.

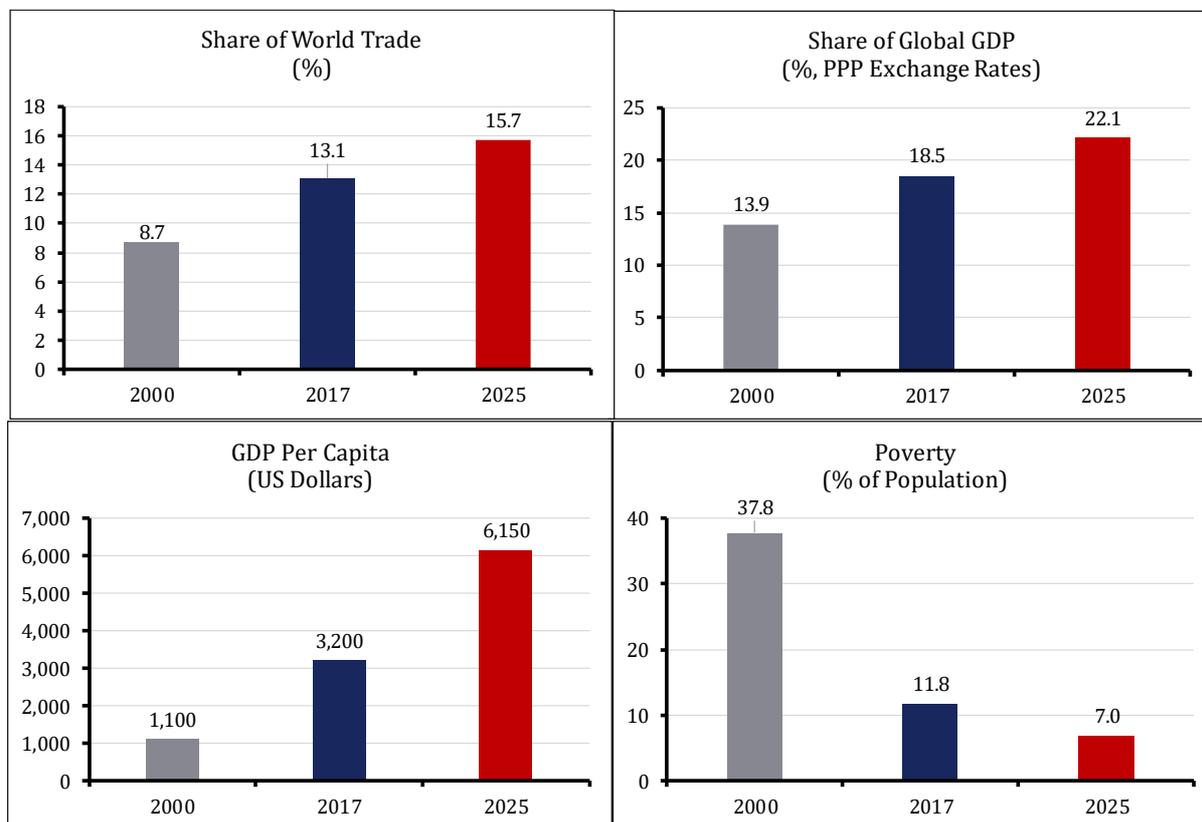
The regional outlook appears more favourable than the global outlook. Regional trade volume growth is expected to pick up to 6.5% per year in 2018-2020, and be supportive of regional growth at 5.8% per year in 2018-2020 (see Figure 2).

However, several risks could tilt the regional economic outlook at least in the short-term. These include escalating trade conflicts between major economies, rising interest rates driven by the tightening of monetary policy in advanced economies, rising oil prices, and waning investor confidence in emerging markets. Progress on domestic economic reforms can also have a bearing on the Indian Ocean’s outlook.

3. Prospects to 2025

Setting these near-term risks aside and assuming the continuation of the positive economic trends seen since 2000, the Indian Ocean economy is likely to play a notable role in the world economy by 2025 with improved prosperity. This ‘business as usual’ scenario is based on projections of several key indicators for the Indian Ocean economy (see Figure 3).

Figure 3: The Indian Ocean Economy in 2025



Sources: LKI calculations based on World Bank, World Development Indicators Database, Available at: <https://data.worldbank.org/topic/poverty>. Accessed on July 2018; IMF, World Economic Outlook Database, Available at: <http://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx>, Accessed on July 2018.

The main regional projections are: ⁵

- The Indian Ocean economy’s share of world trade in goods and services is expected to rise from 13.1% to 15.7% between 2017 and 2025.
- Similarly, the Indian Ocean economy’s share of global GDP (at PPP exchange rates) is expected to rise from 18.5% to 22.1% between 2017 and 2025. This will place it in the league of other major players such as China, the US and the EU.
- The Indian Ocean Economy’s per capita GDP (current USD) is likely to almost double from USD 3,200 to USD 6,150 between 2017 and 2025.
- The share of the region’s population living in extreme poverty (defined as an income level of less than USD 1.90 per day) could fall from 11.8% in 2017, to 7.0% by 2025.

⁵ See Wignaraja, G., Collins, A., and Kannangara P. (2018), “Is the Indian Ocean Economy a New Global Growth Pole?” LKI Working Paper No 2 for details of forecasting methodology. www.lki.lk

- Variations between the sub-regions seem likely. For instance, in 2025 South Asia is likely to account for 12.1% of global GDP, East Asia and the Pacific for 7.1%, and Africa and the Middle East for 2.9%.

4. Selected Policy Challenges

However, the continued economic dynamism of the Indian Ocean economy is not guaranteed. It could be affected by several challenges that could yet undermine the region's prosperity. At the very least, failing to address these issues will mean the region's economic potential is left underexploited. Dealing with all the challenges facing such a vast region, including issues as diverse as climate change, maritime security threats, and poor national governance, is beyond the scope of this issues paper. But in terms of trade-led growth, the key driver of regional prosperity - four challenges appear most pressing.

Ports and Customs Quality

Gaps in port infrastructure and onerous customs procedures are an important barrier to maritime trade as they increase the cost of moving products across borders.⁶ While comprehensive intercountry comparison of infrastructure quality and customs procedures are difficult, a few indicators provide an insight. The Quality of Port Infrastructure component of the World Economic Forum's Global Competitiveness index,⁷ suggests that the average quality of ports in the Indian Ocean economy (4.2) typically lags behind that of the Organisation for Economic Co-operation and Development (OECD) (5.0). More developed regional economies appear to generally have better ports than less developed economies, particularly those in Africa.

In specific relation to customs, the Trading Across Borders indicator compiled by the World Bank⁸ shows how many hours, on average, a country takes for border compliance. In the Indian Ocean, it takes an average of 65 hours for border compliance. In terms of sub regions, South Asia is the slowest, with an average of 73.2 hours while Africa and the Middle East is the fastest with an average of 62.3 hours.

Amidst fiscal constraints, many Indian Ocean economies need to undertake public investment in port development and customs modernisation. The emerging collection of mega-regional infrastructure initiatives—such as China's Belt and Road Initiative (BRI), Japan's Partnership for Quality Infrastructure, the Africa-Asia Growth Corridor, the EU Investment Plan and ASEAN's Master Plan for Connectivity—and international financial institutions can also facilitate investment in ports and trade facilitation. However, these competing large-scale initiatives and donor programmes may also present some challenges to recipients, including a lack of coordination between competing donors, differing social and environmental standards,

⁶ De, P. (2009), *Globalisation and the Changing Face of Port Infrastructure: The Indian Perspective*, Bern: Peter Lang.

⁷ World Economic Forum, The Global Competitiveness Report 2017-2018, Available at <https://www.weforum.org/reports/the-global-competitiveness-report-2017-2018>, Accessed on July 2018. Data not available for Comoros, Iran (Islamic Republic of), Somalia and the Maldives.

⁸ World Bank, Doing Business Database, Available at <http://www.doingbusiness.org/data/exploretopics/trading-across-borders>, Accessed August 2018

insufficient progress on the domestic regulatory reforms needed to maximise the benefits of new infrastructure, and risks to debt sustainability in recipient economies.⁹

Barriers to Trade and Investment

Import tariffs in most Indian Ocean countries have fallen significantly since the 1990s in line with global trends, but murky non-tariffs measures (NTMs) impede goods trade. The weighted average tariff rate in the Indian Ocean fell from 7.6% in 2000 to 2.8% in 2016.¹⁰ The numbers of NTM's initiated and notified to the World Trade Organization (WTO) by Indian Ocean economies rose from 128 to 686 between 2000 and 2017. The bulk of NTMs initiated in 2017 were technical barriers to trade (59.9%) and sanitary and phytosanitary measures (32.2%).

Barriers to trade in services also seem prevalent in the Indian Ocean. Admittedly, the extent of these barriers is difficult to quantify as they can take various forms, ranging from licensing or accreditation to provide a service in a country, to restrictions on foreign companies in certain sectors or even tourist visa fees. The World Bank's Services Trade Restrictiveness Index¹¹ suggests that barriers to services trade in the Indian Ocean (36.7) are high relative to the OECD (19.5). South Asia appears to be more restrictive than other sub-regions when it comes to trade in services. Behind the border regulatory barriers are an additional deterrent to trade and foreign investment across the Indian Ocean. For instance, it takes an average of 22 days to start a business in the Indian Ocean economy compared with an average of only 8 days in the OECD.¹²

Gradually reducing barriers to trade and investment would support trade-led growth in the Indian Ocean. However, to benefit from liberalisation, factors of production needs to be reallocated between and within sectors. This structural change is a key source of the gains from trade, but brings with it costs of adjustment.¹³ Some workers face temporary unemployment and income losses through jobs lost to international competition. Accordingly, the speed, stages, and sequencing of trade and investment reforms need to be tailored to individual national circumstances. This should be accompanied by suitable trade adjustment programmes to retrain workers in sectors displaced by foreign competition and provide better financial access for small and medium enterprises (SMEs).

Development Gaps

Significant economic progress over recent decades notwithstanding, development disparities and capacity gaps remain between Indian Ocean economies. In March 2018, the United Nations

⁹ See H. Yoshimatsu (2017), "Japan's Export of Infrastructure Systems: Pursuing Twin Goals Through Development Means" *The Pacific Review*, 30:4; Hurley, J. S. Morris and G. Portelance (2018), "Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective", *CGD Policy Paper* 121, March (Center for Global Development).

¹⁰ WTO, Trade and Tariff Database, Available at: https://www.wto.org/english/res_e/statis_e/statis_e.htm, Accessed on July 2018.

¹¹ World Bank, Services Trade Restrictions Database, Available at: <http://iresearch.worldbank.org/servicetrade/>, Accessed on June 2018

¹² World Bank, Doing Business Database, Available at <http://www.doingbusiness.org/data/exploretopics/trading-across-borders>, Accessed August 2018

¹³ See Francois, J., M. Jansen and R. Peters (2011), "Trade Adjustment Costs and Assistance: The Labour Market Dynamics" in Jansen, M., R. Peters and J.M. Xirinachs (eds), *Trade and Employment: From Myths to Facts*, Geneva: International Labour Organisation and Brussels: European Commission.

classified ten regional economies as less developed countries (LDC) including Bangladesh, Cambodia, Comoros, Madagascar, Mozambique, Myanmar, Somalia, United Republic of Tanzania, Timor-Leste and Yemen.¹⁴ LDCs face significant structural impediments to sustainable development and typically have lower per capita incomes than other regional economies. They are also vulnerable to economic and environmental shocks and have low levels of human development.

While the diversity of the region's economies in terms of income levels presents an opportunity for mutually-beneficial trade based on each country's comparative advantage, development gaps impede LDCs from fully engaging in trade-led growth. Financial constraints restrict national investments in port and logistics infrastructure that would improve their quality and reduce trade costs. LDCs also rely on trade-related taxes for a larger share of their revenue as limitations in tax administration capacity and large informal sectors undermine the efficacy of other forms of taxation, which further raises trade costs. Moreover, SMEs located in LDCs lack international competitiveness and the ability to join global value chains. At the same time, skills deficits and difficult business environments deter export-oriented foreign direct investments that would allow LDCs to engage in trade in higher value-added sectors.

Foreign aid flows appear insufficient to close these development gaps. Total foreign aid to Indian Ocean economies as a group, doubled from USD 12.4 billion to USD 25.1 billion between 2000 and 2016. However, the bulk of such aid is concentrated in a few countries. Aid flows remain low in other economies which have large trade-related needs and high poverty levels. Accordingly, there have been high-level political calls by Sri Lanka's Prime Minister for the establishment of an Indian Ocean Development Fund to provide loans, grants and technical assistance to enhance economic development in regional economies.¹⁵

An additional risk is that some countries could find themselves stuck in the 'missing middle' of development finance, when total resources available fall as the country moves from low towards middle-income status.¹⁶ Some middle-income countries also lack the requisite technical knowledge to build institutions for fostering trade-led growth, such as world class ports and bodies for negotiating comprehensive free trade agreements (FTAs). A case, thus, exists for external development assistance and knowledge transfer to support the middle-income transition in the Indian Ocean economy. Fostering public-private sector partnerships (PPPs) for port development and better targeting countries with rising inequality and fragile situations are essential to more effectively utilise scarce external assistance.

¹⁴ <https://www.un.org/development/desa/dpad/least-developed-country-category/ldcs-at-a-glance.html>

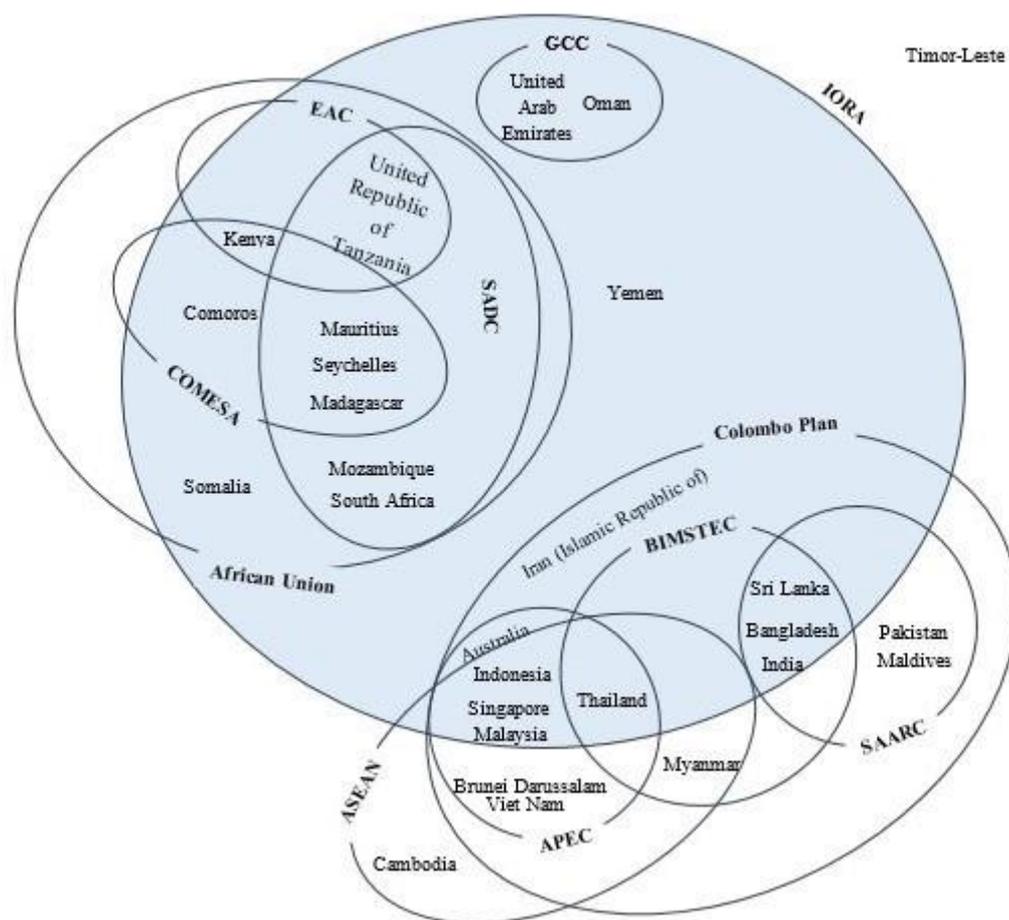
¹⁵ Prime Minister's Office of the Democratic Socialist Republic of Sri Lanka, Inaugural Address delivered by Hon. Ranil Wickremesinghe, Prime Minister of Sri Lanka at the Indian Ocean Conference on 1 September 2016, Shangri La Hotel, Singapore, Global Power Transition and the Indian Ocean; http://www.pmooffice.gov.lk/download/press/D00000000050_EN.pdf?p=7 (last accessed 25 September 2016).

¹⁶ Wignaraja, G., J. Tyson, A. Prizzon and D.W te Velde (2018), *Asia in 2025: Development Prospects and Challenges for Middle-Income Countries*, London: Overseas Development Institute, September. <https://www.odi.org/publications/11202-asia-2025-development-prospects-and-challenges-middle-income-countries>

Nascent Regional Economic Governance

A classic hub and spoke network of some 11 regional institutions and several FTAs include multiple Indian Ocean countries (see Figure 4). The hub of the network is the Indian Ocean Rim Association (IORA), which covers the majority of the Indian Ocean economies. Multiple spokes include several mostly smaller sub-regional institutions that count Indian Ocean economies among their membership, such as Association of South-East Asian Nations (ASEAN), the Gulf Cooperation Council (GCC), and the Southern African Development Community (SADC). A number of Indian Ocean countries are also included in cross-regional institutions such as the Asia-Pacific Economic Cooperation (APEC).

Figure 4: Network of Regional Institutions governing the Indian Ocean



Source: Compiled using information available on official websites of these respective institutions.

This network of regional organisations is at a nascent stage of institutional development compared to those in the Americas or Europe. Many have limited delegated powers from members, lack formal rules or legal structures, have inadequate financial resources and lack permanent secretariats. For example, IORA’s secretariat has less than 20 staff members working on six priority areas, of which promoting trade and investment is just one.¹⁷ While the

¹⁷ Waidyatilake (2017), “The Indian Ocean Rim Association: Scaling Up?” *LKI Policy Briefs*, July. https://www.lki.lk/wp-content/uploads/2017/07/LKI-Policy-Brief_The-Indian-Ocean-Rim-Association-Scaling-Up_Barana-Waidyatilake.pdf

stated objectives of these institutions all make some reference to pursuing economic prosperity, in practice, they have overlapping agendas with differing emphasis on promoting regional economic integration. Of the 11 regional institutions, only six have a trade agreement in force and the scope and ambition of these agreements vary significantly.

Adding to this tangle of regional institutions are around 10 bilateral FTAs between Indian Ocean economies. These are exclusively between countries in the South Asian, and East Asian and Pacific sub-regions of the Indian Ocean, and the scope of trade liberalisation varies significantly. Further complicating matters, 52 bilateral investment treaties between countries in the Indian Ocean formalise rules for bilateral investment, as well six additional bilateral FTAs or economic cooperation agreements that contain investment provisions.

Given the diversity of Indian Ocean economies, it is perhaps inevitable that the quest for Indian Ocean economic regionalism is likely to remain ‘institution light’ for the foreseeable future. However, the Indian Ocean’s existing hub and spoke network of regional institutions and FTAs could be strengthened. One step would be to appoint an Eminent Persons Group (EPG) from member states tasked with developing a plan to strengthen IORA’s role in regional economic governance. The EPG’s review should provide a vision for IORA’s role in regional economic governance, as well as delegated powers from members, formal rules and legal structures, financial resources and a permanent secretariat.

Another step would be to encourage linking the various sub-regional and bilateral FTAs in the region to a mega-regional trade agreement with common trade rules and standards. This would increase market access, reduce trade barriers and facilitate regulatory coherence. It would also help insure against rising protectionist tendencies internationally. Asia’s mega-regional trade agreement – the Regional Comprehensive Economic Partnership (RCEP) – seems to be a reasonable candidate. This agreement is currently under negotiation among 16 Asia-Pacific economies including important Indian Ocean economies like Australia, Cambodia, India, Indonesia, Malaysia, Singapore and Viet Nam. RCEP has an open accession clause which means other economies can join the agreement at a later date. Furthermore, RCEP addresses the special needs of less-developed ASEAN economies through early elimination of tariffs on products of interest to them, and the provision of development assistance to narrow development gaps.

Questions for Discussion

1. What are the most pressing risks to the outlook for the Indian Ocean economy?
2. How can national and regional initiatives used to improve the quality of port infrastructure in the Indian Ocean (e.g. Belt & Road Initiative, Asia-Africa Growth Corridor) be effectively dovetailed?
3. What concrete steps should be taken to strengthen regional economic governance?
4. Is an Indian Ocean Development Fund an optimal solution to development gaps?
5. How should the residual barriers to trade and investment flows in the Indian Ocean be addressed?
6. How do traditional and non-traditional security issues threaten the Indian Ocean's economic prosperity?
7. How can greater Asia-Africa trade and investment links be fostered?

Table A1: Key Indicators for Indian Ocean Region Economies

Country	Population (Millions, 2017)	Land Area (Thousand Sq. Km)	GDP (USD Billions, 2017)
<u>Africa and the Middle East</u>	359.4	7,217.8	1,426.8
<i>(Share of World)</i>	<i>(4.8%)</i>	<i>(5.5%)</i>	<i>(1.8%)</i>
Comoros*	0.8	1.9	0.7
Iran (Islamic Republic of)*	81.2	1,628.8	431.9
Kenya*	49.7	569.1	79.5
Madagascar*	25.6	581.8	11.5
Mauritius*	1.3	2.0	12.4
Mozambique*	29.7	786.4	12.7
Oman*	4.6	309.5	74.3
Seychelles*	0.1	0.5	1.5
Somalia*	14.7	627.3	7.4
South Africa*	56.7	1,213.1	349.3
United Arab Emirates*	9.4	83.6	377.4
United Republic of Tanzania*	57.3	885.8	51.7
Yemen*	28.3	528.0	16.5
<u>South Asia</u>	1,578.6	3,819.5	3,031.0
<i>(Share of World)</i>	<i>(20.9%)</i>	<i>(3.0%)</i>	<i>(3.8%)</i>
Bangladesh*	164.7	130.2	261.4
India*	1,339.2	2,973.2	2,611.0
Maldives	0.4	0.3	4.5
Pakistan	53.4	653.1	66.5
Sri Lanka*	20.9	62.7	87.6
<u>East Asia and the Pacific</u>	705.2	11,706.0	4,050.7
<i>(Share of World)</i>	<i>(9.3%)</i>	<i>(9.0%)</i>	<i>(5.1%)</i>
Australia*	24.5	7,741.2	1,379.5
Brunei Darussalam	0.4	5.8	12.7
Cambodia	16.1	181.0	22.3
Indonesia*	264.0	1,910.9	1,015.4
Malaysia*	31.6	330.8	314.5
Myanmar	197.0	676.6	304.0
Singapore*	5.7	0.7	323.9
Thailand*	69.0	513.1	455.4
Timor-Leste	1.3	14.9	2.6
Viet Nam	95.6	331.0	220.408
Indian Ocean Total	2,643.2	22,648.8	8,508.5
<i>Share of World</i>	<i>35.0%</i>	<i>17.5%</i>	<i>10.7%</i>

Notes: * Members of the Indian Ocean Rim Association (IORA).

Sources: Compiled by LKI based on data from UN DESA, Available at: <https://esa.un.org/unpd/wpp/>, Accessed on July 2018; World Bank, Food and Agriculture Database, Available at: <https://data.worldbank.org/indicator/AG.LND.TOTL.K2>, Accessed on July 2018; IMF, World Economic Outlook Database, Available at: <https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspxd> on July 2018