SPECIAL REPORT no. 179

Connectivity and Commerce Imperatives in the Indo-Pacific

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JANUARY 2022

Abstract

In recent times, the centre of gravity for global trade and economic activities has shifted to the Indo-Pacific and, consequently, there is heightened competition between global powers that have stakes in the region. The importance of connectivity has therefore come to the forefront, covering domains like digitisation with interoperable regimes comprising data protection and cyber security, along with cross-border infrastructures that need attention. This report outlines the complexities and prospects related to digital and physical connectivity in the Indo-Pacific.

Attribution: Soumya Bhowmick and Sohini Nayak, "Connectivity and Commerce Imperatives in the Indo-Pacific," *ORF Special Report No. 179*, January 2022, Observer Research Foundation.

Divergent Views of the Indo-Pacific

The Indo-Pacific is a complex construct and a relatively new one, still lacking a clear definition and involving conflicting security, strategic, political, and economic interests. Enhancing trade and connectivity in the region is an extended process as it remains largely intertwined with global geopolitics as well as the domestic politics of the countries in the region. As each country in the Indo-Pacific tries to maximise its own geopolitical, security, and economic benefits, their actions can result in conflict.

Indeed, the very idea of the "Indo-Pacific" varies according to the country which defines it. For instance, the United States's (US) view is mainly security-centric, although it has clear aspirations to reap economic benefits from its activities in the region.[1] Keeping the rise of China under check is also an explicit agenda under the US vision of its Indo-Pacific engagements. Meanwhile, New Delhi's view of the Indo-Pacific is more multi-dimensional and inclusive, emphasising the development of the Indo-Pacific countries and economic cooperation between them. Similarly, the 'Free and Open Indo-Pacific Strategy (FOIPS),[2] which the former Japanese Prime Minister Shinzo Abe outlined in 2016 got widespread acceptance and support from the US-led anti-China coalition, including countries like India and Australia. All these developments manifest growing convergence and shared interests among the major players in the region. Yet there remains a gap in mapping a common agenda based on shared political, economic and connectivity aspirations.

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Similarly, there are differences in the notion of what encompasses the geographic region. As far as Washington is concerned, it ends with the West Coast of India. New Delhi, for its part, sees the area from the Western Pacific to the Horn of Africa as part of the Indo-Pacific. Such divergent views have implications on regional trade and connectivity as will be discussed later in this report.

What is clear is that the rise of the "Indo-Pacific" has triggered responses from Beijing. The Chinese leadership clearly recognises that the underlying principles of the Indo-Pacific are directed towards its political, economic and military rise in the region. In the words of Yu Jie at the Chatham House, the increasing prominence of the Indo-Pacific poses a huge diplomatic challenge to the Chinese leadership and compels it to rethink its policy priorities. Jie argues that "Beijing's foreign policy deliberation is being rigorously tested with this increasing tilt by the West towards the Indo-Pacific. For China, this tilt complicates the already erratic relations between Beijing and Taipei, escalates the sabre-rattling in the South China Sea, and disrupts its flagship Belt and Road Initiative, which the country has invested heavily in."[3]

However, the strategic and economic dimensions of the "Indo-Pacific" place China on two extremes. While the strategic dimension spearheads against Beijing, its economic significance makes China an integral part of trade and connectivity endeavours in the region. For every country in the Indo-Pacific, except Bhutan, China is a larger bilateral trading partner than the US. Moreover, China is an inevitable part of the Indo-Pacific supply chains and a crucial trading partner for countries, even Japan, South Korea, and Australia. For example, in 2020, 22.9 percent of Japanese exports went to China.[4]

Realising its own crucial role in trade and connectivity in the region, Beijing has been positively responding to such efforts, viewing them as opportunities to enhance its global and regional position. China's joining the Regional Comprehensive Economic Partnership (RCEP), and President Xi Jinping's positive response to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) both show that Beijing will not prefer economic isolationism in the Indo-Pacific and is willing to cooperate in trade and connectivity in the region.

The BRI and RCEP

Multiple factors influence the prospects of trade and connectivity in the Indo-Pacific. These include the geopolitical apprehensions regarding the rise of China, perceptions about the Belt and Road Initiative (BRI), the US-China trade war, Brexit, Donald Trump's denial of the climate crisis, growing nationalist fervour, protectionism, and Sino-Indian border conflicts.

Security and economic issues are interconnected in the Indo-Pacific space. China's rise as an economic and military power has substantial implications on trade and connectivity in the region. Indeed, an idea of a new economic global order has emerged since China announced the BRI more than seven years ago. Many experts agree that the BRI is a global development strategy involving infrastructure projects in nearly 70 countries to exploit the cheap factor markets and expand product markets.[5] According to estimates by these analysts, Beijing has pumped in approximately USD200 billion on BRI projects across the world. The US banking firm, Morgan Stanley, estimates that by the end of 2027, total Chinese investments in BRI could touch somewhere between USD1.2 and 1.3 trillion.[6]

More countries are signing on to the BRI, causing a stir in the Indo-Pacific status quo. In turn, the responses of countries like the US, Japan, and India, are adding more complexities to the Indo-Pacific strategic landscape. While Chinese influence is on the rise, new security groupings such as the Quadrilateral Security Dialogue (Quad) and AUKUS (Australia, UK and US) are emerging in response. The growing geopolitical tensions are casting a long shadow on the process of economic integration and free movement of goods and services in the region and beyond. Yet little space has been accorded to these aspects in current analyses of Indo-Pacific affairs.

For New Delhi, its policy response to the BRI is influenced by these developments. Even if the BRI promises to offer economic gains, joining it was politically unviable for New Delhi because the China-Pakistan Economic Corridor (CPEC) that passes through Pakistan-Occupied Kashmir violates India's territorial integrity.[7] Similarly, New Delhi views Chinese investments in ports and airports in its neighbourhood as efforts to strategically encircle India.[8] New Delhi's decision to stay out of the RCEP had been similarly driven by the China factor: in India's view, the obligations that are part of the deal will constrain it from taking hard stances in trade with China.[9]

In the absence of an underlying economic integration in the Indo-Pacific, the responsibility falls on the individual states. Although there have been efforts at regional integration dating back to many decades—such as the Association for Southeast Asian Nations (ASEAN)—they have failed to bring sufficient economic integration in the region. While it is true that the RCEP could have played a larger role, by itself it is insufficient for several reasons. First, the RCEP represents only a small part of the Indo-Pacific, which extends up to the Eastern coast of Africa. Second, beyond signing trade agreements, the quality and commitments of the signatories to the agreement are also important. In the case of RCEP, the commitments of countries are far smaller than their bilateral ones.

Compared to developed Europe and North America, Indo-Pacific, overall, faces substantial constraints in connectivity. Moreover, as the Indo-Pacific encompasses a wide geographic region involving countries in varying stages of development, there also exists a huge divide in connectivity within the sub-regions. Enhancing the physical and digital connectivity, and bridging the connectivity gap among countries is key to the economic development of the region.

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Connectivity: Key to Commerce and Supply Chains

The Indo-Pacific is often described as the fastest growing region in terms of internet adoption and digital connectivity.[a] However, despite such progress, weak e-commerce, underdeveloped e-governance, and a fragile cyber security framework have cost the region economic losses of around USD 300 billion a year.[10]

Timor Leste in Southeast Asia, for example, is overwhelmingly dependent on Indonesia for digital connectivity via underwater cables; this costs the country high. Yet the experience is not unique to Timor Leste, and the entire Indo-Pacific largely faces a massive lack of underwater cables for connectivity. Japan might be pulling up the average with its sufficient undersea cable connectivity, but the Bay of Bengal region, for example, lags. Bangladesh, for instance, is connected to two consortium cables. Five years ago, it was connected to only one; some years ago in 2005, it had no connection. This has been a clear progress over time, but the pace is hardly sufficient. In the case of terrestrial cables too, the situation is not that different.[b] In contrast, Europe and North America are rich in cables, both underwater and terrestrial.

Similarly, the requirement for physical infrastructure in the region has also increased in the recent past with rapid urbanisation and governmental focus on newer sectors of the economy. While advanced digital connectivity, on its own, can aid in the trade of services, physical connectivity also demands priority.

a Digital connectivity enhances the movement of goods. The impact of digital connectivity on the trade of goods and on services is different and thus needs to be dealt with separately.

b Terrestrial cables have huge significance as they are more resilient and capable of overcoming disruptions at any point.

For instance, before an aircraft lands on an airstrip or a ship arrives in a port, enormous amounts of data need to be processed and analysed, and approvals need to be obtained to facilitate such movement of goods. However, in order to enhance trade, to begin with, physical connectivity is required. Enhancing the overall connectivity helps to enhance the economic opportunities for the entire population. The vast connectivity becomes highly productive when it comes to areas like e-commerce. The reduction in transaction costs that accompanies the growth in digital connectivity would allow the smaller players to benefit from e-commerce.

In 2019, general construction in the Indo-Pacific region was estimated to reach an 8.9 percent compound annual growth rate by 2023. In this regard, the Asian Development Bank had hinted at an investment of USD 1.7 trillion annually till 2030 specifically for infrastructural development.[11] There is the absence of telecommunication, transportation or energy links. And these gaps do not stem from only the lack of capital supply, as most regional economies have high savings rates. The presence of insufficient policy factors is primarily responsible for the dearth in both public and private-sector investments. These are also known as "bankability" problems that collectively refer to the lack of technical capacity to identify, design and develop projects; public-sector capacity to implement complex financial and engineering arrangements; and an absence of non-governmental mechanisms to mobilise private finance to supplement public funding. With the outbreak of the COVID-19 pandemic, infrastructure development has been severely challenged, with sluggish investments, and a decline in asset utilisation and solvency challenges throughout the Indo-Pacific.[12]

The pandemic, the subsequent lockdowns that were implemented by governments as a response, and the resultant disruptions in the supply chain have compelled ordinary people, policymakers, business leaders, and governments across the globe to rethink trade and connectivity. The pandemic has also made societies turn to digital solutions for connecting with others, thereby giving a big push to the digital sector across the globe, including in the Indo-Pacific. At the same time, as supply chains got disrupted by the lockdowns in different regions, nations were compelled to move towards greater supply-chain resilience through diversification.[c]

c Resilience, in the words of Oksana Palekiene, is the ability "to withstand and recover from external pressure or shock in order to maintain... growth path close to potential or, if it is necessary, to reorganize its structure and transit to the new growth path." The ways to achieve resilience are "diversification, domestic capacity, and strength of regulation." See: Oksana Palekiene et. al, 'The application of resilience concept in the regional development context', *Procedia – Social and Behavioral Sciences* 213 (2015): 179–84, https://cyberleninka.org/article/n/1375349.pdf

Some multi-national initiatives have been launched in this regard, such as the ASEAN-Japan Joint Initiative on Economic Resilience,[13] and the Supply Chain Resilience Initiative[14] of India, Japan, and Australia.

These initiatives will necessarily aim to reduce dependence on China, which plays a pivotal role in Indo-Pacific supply chains. Yet, attaining supply-chain resilience through diversification is not an easy task and is encumbered by various obstacles. For one, it is often impossible to replicate a similar environment in another region. Diversification of high-technology industries also becomes virtually impossible given how only a few nations—such as Japan, the US, or Taiwan—possess the required sophisticated technologies and highly skilled labour to carry out the production process. It becomes financially unviable, or extremely difficult to replace or diversify such supply chains in these circumstances. Many other sectors are similarly difficult to replace, for example, mining or agriculture. Mining can be done only where a particular natural resource is available; and agricultural production can only occur in particular regions with required environmental resources and suitable climate.

The financial costs also hinder the process of diversification of supply chains. A favourable environment to carry out production at lower costs makes specific destinations such as China and India more attractive for producing goods and services. Although geopolitical reasons might compel countries to diversify or replace supply chains, financial considerations can stonewall ambitions.

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Challenges for India's Integration in the Indo-Pacific

As a growing economy and regional player, India is undertaking efforts to scale up its role in trade and connectivity in the Indo-Pacific, guided by its 'Act East' policy.[15] According to a study by the Confederation of Indian Industries (CII) in 2020, India registered a trade surplus with nine out of the 20 Indo-Pacific countries covered by the survey. Its trade with select economies in the region has grown eight times since 2001—from USD33 billion that year, to USD262 billion in 2020.[16]

During the Shangri-La Dialogue held in Singapore in 2018, Indian Prime Minister Narendra Modi presented the country's Indo-Pacific strategy. Rather than focusing on a single aspect such as security or trade, the Ministry of External Affairs (MEA) announced, "India calls for a free, open and inclusive order in the Indo-Pacific, based upon respect for sovereignty and territorial integrity of all nations, peaceful resolution of disputes through dialogue and adherence to international rules and laws."[17] However, for many reasons, India's engagement and leadership in the Indo-Pacific remains limited. India must better integrate its foreign policy and economic diplomacy. The push by the Indian government to develop specific areas and exert more influence in regional trade has met with some success. For example, although India continues to fill 60 percent of its requirement for electronics via imports from China, it has developed domestic industries in the sector. India has also achieved progress in the trade of services, even as most of it has been centred on Information Technology (IT).

India's share remains marginal in the other 12 categories of services listed by the World Trade Organization[18] including education, tourism, and healthcare.

Overall, India's economic performance in the region is hardly sufficient to counter growing Chinese influence. This is seen specifically in India's trade and economic relations with the ASEAN. While India underlines the principle of "ASEAN centrality" to be at the core of its Indo-Pacific strategy—and as it tries to forge closer economic and strategic partnerships with the ASEAN member states—India's volume of trade with the countries of the bloc is nowhere close to that of China.

It would do India well to improve its economic ties with ASEAN, as it works to enhance its stature in the Southeast Asian region and the broader Indo-Pacific. To be sure, China's remarkable rise remains the most important strategic and security concern for the Southeast Asian countries. At the same time, these countries are wary of making any decisions that could irk Beijing, given the promised benefits of prosperous trade and economic ties with China.

Figure 1 illustrates India's trade with ASEAN from 2014 to 2021. In 2019-20, India-ASEAN bilateral trade accounted for around 11 percent of India's total global trade—an exponential growth when compared to just one percent in 2010-11. In spite of such growth, however, India-ASEAN trade ties are still far behind those of China and ASEAN. In 2020-21 (see figure 2), India-ASEAN trade was recorded at USD 78.9 billion; China-ASEAN trade in the same year was USD 683.8 billion or around seven times more than India's. Indeed, for the last 12 years, China has remained ASEAN's largest trading partner. In 2021, ASEAN surpassed the European Union to become China's largest trading bloc.

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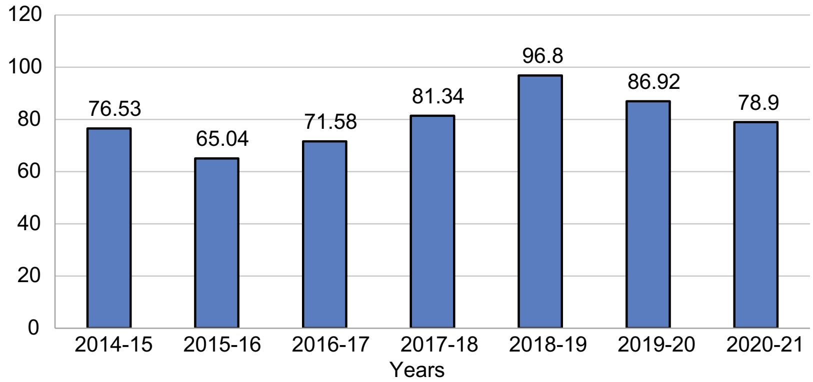
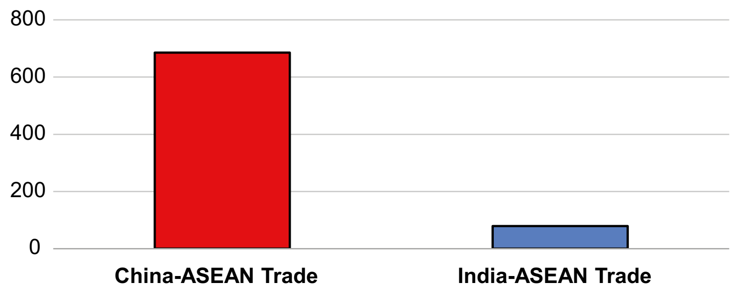
Figure 1:
India-ASEAN Trade Volumes (in USD Billion)



Source: Authors' own, using data from the Ministry of Commerce and Industry, Government of India[19]

Figure 2:
Chine-ASEAN Trade versus India-ASEAN Trade, 2020-21 (in USD Billion)



Source: Authors' own, using data from China International Import Expo[20]

Similarly, India also lags in terms of Foreign Direct Investments (FDI). The inward and outward FDI flow between China and the Southeast Asian countries is of far larger volume when compared to that between India and these economies. As China leads the world in terms of outward FDI investments, there have been reflections of the same in the Indo-Pacific and Southeast Asia. China has been one of the top sources of FDI investments for the Southeast Asian countries while India is far behind.[21]

Trade and economic leverage over Southeast Asian countries helps China strengthen its position in the region, despite the increasing political distrust between China and ASEAN countries.[22] The dilemma in balancing the economic and strategic priorities is not only the case of ASEAN in the Indo-Pacific. Even countries that are at the forefront of coalitions against Beijing, such as Australia, Japan and South Korea, also fall in the same category. While these countries view China as a critical threat to their security and territorial integrity, they continue to maintain their bilateral trade ties. Although the rise of China increasingly causes concerns among the countries in the region, the economic prowess of China continues to make it key to the region's economic integration. In order for India to gain strategic prominence in the Indo-Pacific space, it must enhance its own economic capability and scale up economic integration with the region.

In India, the growth in technology has eased production and has enabled companies—for example, those in IT—to carry out work at a single destination, rather than investing huge sums in multiple global destinations. This incentivises Indian firms to de-globalise. Thus, the trans-nationality of multinationals is reducing these de-globalising tendencies of the Indian tech-firms and could erode India's leadership role in the region—after all, technology is a critical area where India has advantage and capacity for contribution. For instance, engineering goods accounted for 40 percent of India's USD46-billion annual exports to ASEAN in 2021.[23] To play a more active role in the regional economic order and impact the supply chains, Indian MNCs should play a much larger role and become more global.

For India to play a meaningful role in the supply chains in the Indo-Pacific, it needs to be part of trade agreements that involve the US and Japan. Indeed, India's withdrawal from the RCEP is widely regarded as a blow to the country's ambitions at regional economic integration. The reason for India's reluctance to join the RCEP has been the lack of economic incentives; domestic pressure also played a role. As the Indian economy is still immature to compete with the highly advanced economies like Taiwan, and other nations from Southeast Asia, joining such trade agreements could hurt domestic producers. India must therefore continue efforts for regional economic integration and play a far more significant role in the regional supply chains. The availability of cheaper goods would benefit the country's customers. At the same time, India needs to protect domestic industries against the flooding of cheaper imports from other countries, which could result from being part of certain of trade agreements.

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Conclusion

A divergence of interests is a key hindrance to efforts at enhancing trade, connectivity and, ultimately, the economic integration of the Indo-Pacific region. Thus, generating consensus and maintaining flexibility are two of the most crucial strategies that can help facilitate such integration. To be sure, various initiatives have emerged in the recent years, all aiming to navigate common interests in trade and connectivity. However, many challenges are casting their shadow on these efforts: security concerns, geopolitical competition, border conflicts, and political distrust.

The rise of China is critical in this matter. Stakeholders such as the US, India, Japan and Australia, view China's rise with suspicion—this narrows the scope for mutual cooperation. For example, India has security concerns regarding the BRI, and would therefore rather miss out on the potential economic benefits of the project.

The asymmetry in the physical infrastructure development is another hindrance to regional cooperation and integration. As technology becomes even more critical to economic activities, a capacity-deficit in the smaller economies carries the threat of an even wider trans-national technology divide. The larger and more technologically advanced nations, including India, must scale-up their assistance to the smaller states.

One of the primary frameworks that can help establish this area as a zone of cooperation is the creation of multilateral or mini-lateral frameworks that will pave the way for collaborative opportunities. This can bring about the convergence of interests, discernment of threat in the region, and practical and feasible solutions to be undertaken at the track 1.5 and 2 levels—in turn increasing the chances of success.[24] It is important to invest in a diverse range of cooperative institutions with different stakeholders interacting with one another, with similar ambitions in mind, thus making connectivity and trade games positive-sum in nature.

Authors' Note

This report is drawn from the points made by the speakers at ORF's conference - "**Strategic High Tide in the Indo-Pacific: Economics, Ecology and Security**." The report encapsulates the discussions conducted on the second day of the conference on 10 November 2021 (Business Session on **Commerce and Connectivity)**. The webinar was chaired by Nilanjan Ghosh, Director of ORF Kolkata. The following were the speakers:

- Rohan Samarajiva, Founder, LIRNEasia, Sri Lanka
- Takuma Otaki, Advisor, Ministry of Economy, Trade and Industry — Government of Japan; Policy Director, JETRO New Delhi
- Akshay Mathur, Director, ORF, Mumbai
- Arpita Mukherjee, Professor, Indian Council for Research on International Economic Relations, New Delhi
- Saon Ray, Professor, Indian Council for Research on International Economic Relations, New Delhi

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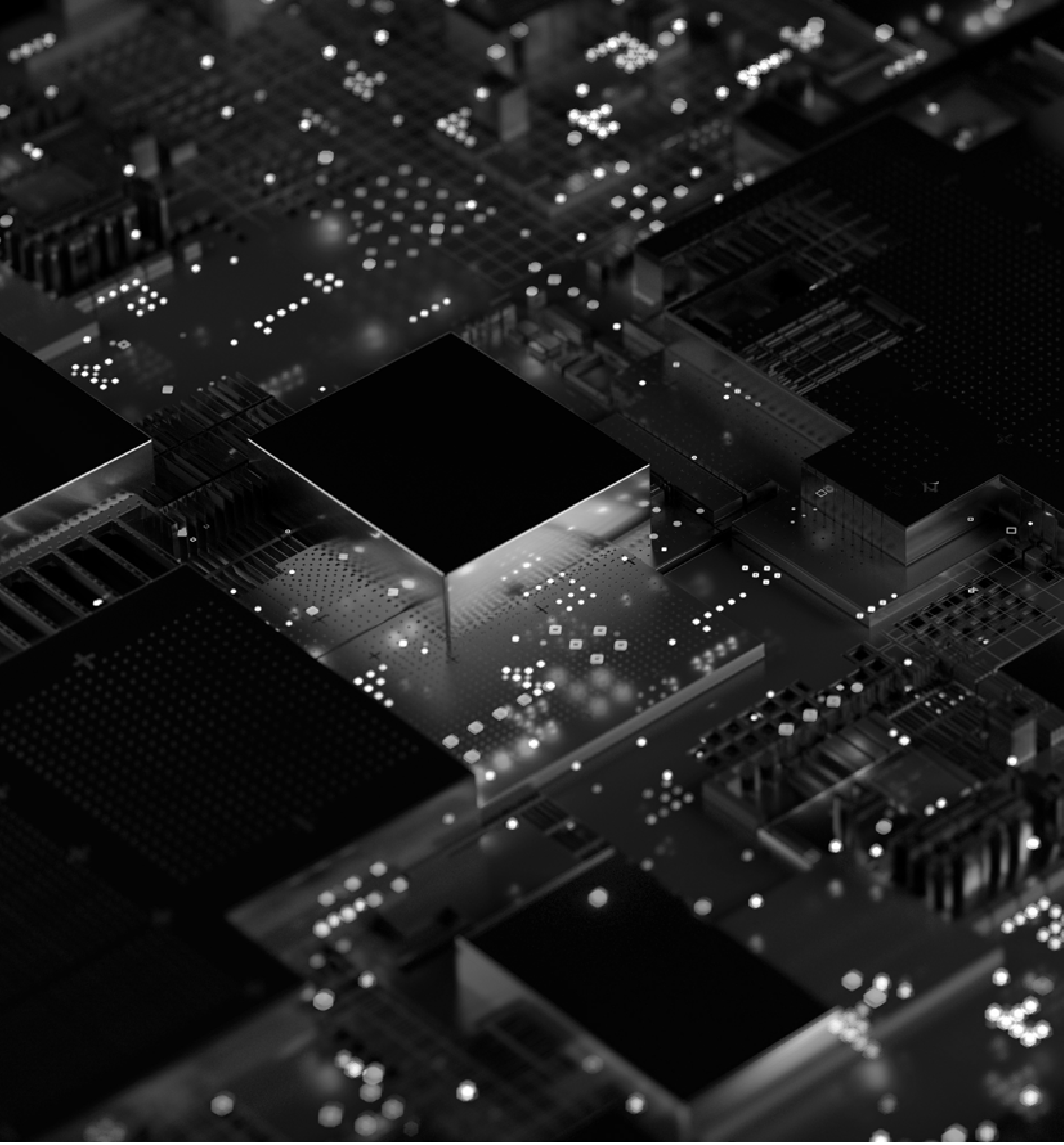

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