

# AN INDO-PACIFIC ECONOMIC CORRIDOR – PREMISES AND IMPLICATIONS OF THE U.S. PROJECT

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## Abstract

Indo-Pacific Economic Corridor (IPEC) project is aimed at promotion of stability and prosperity of South and Southeast Asian economies, using funds managed by the U.S. State Department. Among key activities under IPEC there is an advancement of regional economic connectivity to reach four objectives: to foster economic growth and regional trade in South Asia; to increase private sector competitiveness in the region by enhancing the business environment; to engage the private sector on economic issues, particularly regional trade in South Asia and trade between South and Southeast Asia; to encourage stronger economic integration between South and Southeast Asia, engaging with regional institutions and international financial institutions. The IPEC's vision addresses physical infrastructure, trade integration, energy markets, as well as people-to-people relations.

IPEC may be considered through the prism of hegemonic rivalry with China's Belt and Road Initiative over the influences in the Indian Ocean Rim, Asia-Pacific and Eurasia. Thus, IPEC might be a framework within which the U.S. – in close cooperation with Asian powers (e.g. India, Japan) would attempt to determine the future economic and geopolitical order, whereas countering China's ambitions.

The main objective of the paper is to identify major premises and implications of the Indo-Pacific Economic Corridor project.

**Key words:** Indo-Pacific Economic Corridor, economic integration, physical connectivity.

**JEL Code:** F15, O18, R12, R58

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## Introduction

In the contemporary world economy, regional economic corridors are beginning to play an increasingly important role. Despite the fact that the theory is not unanimous in the recognition of the effects of economic corridors as unequivocally positive phenomena (Srivastava, 2011, 3), more and more such initiatives arise in various parts of the world. It is expected that the increase in economic activity resulting from the corridor building will

increase the potential for economic development. Economic corridors can be also a driver of inclusive growth by bringing lagging regions into the growth process (Brunner, 2013, 4; Sen, 2014, 25).

Indo-Pacific Economic Corridor (IPEC) project is aimed at promotion of stability and prosperity of South and Southeast Asian economies. Among key activities under IPEC there is an advancement of regional economic connectivity. IPEC may be considered through the prism of hegemonic rivalry with China's Belt and Road Initiative over the influences in the Indian Ocean Rim, Asia-Pacific and Eurasia. Thus, IPEC might be a framework within which the U.S. – in close cooperation with Asian powers (e.g. India, Japan) would attempt to determine the future economic and geopolitical order, whereas countering China's ambitions.

The main objective of the paper is to identify major premises and implications of the Indo-Pacific Economic Corridor project.

## **1 Concept of economic corridors**

The concept of trans-regional economic corridors has no strong theoretical background. It is based essentially on the assumptions of the new economic geography while developing also in the field of urban planning and spatial organization of transportation (Sen, 2014, 25; Srivastava, 2011, 2). According to Brunner (2013, 1) economic corridors connect economic agents along a defined geography, linking the demand and supply sides of markets. The basic structural elements of the economic corridor are its external nodes (or urban centers) and transport connectivity between them. The corridor may include smaller nodes lying between the main nodes and the land in vicinity to a corridor.

Srivastava (2011, 10-12) introduces a distinction between a narrow and broad economic corridor as well as between a national and regional one. Narrow corridors operate solely through transportation route while broad corridors cover wider geographical area along the route. In turn, national corridors cover only national areas while regional ones involve agents from two or more countries. Taking into account the four types of corridors indicated above, one can notice the sequence of transition from narrow to wide corridors and simultaneously from national to regional ones. The final effect would be to achieve broad and seamless regional entity as an effect of a corridor transformation.

In the assumptions, the establishment of regional economic corridors should bring benefits such as: increases in incomes, reductions in poverty or alleviation of regional disparities (ADB, 2014, 57). Large accumulated benefits may arise when pro-growth

investments along the corridor increase the production potential of the economically and geographically integrated area. Thus, the economic corridors can be an important driver of growth by including the lagging regions in development processes. However, it should be emphasized that the beneficial economic corridor should be created between nodes, which are important centers of economic activity. As Srivastava notes (2011, 3-4): ‘corridors from “nowhere to nowhere through nowhere” would not be very meaningful’. This means that economic corridors do not function in a vacuum or in an isolation, but rather should be analyzed as an important part of integrated economic networks, such as regional value chains (Brunner, 2013, 1). In addition, a development of corridors in itself does not create an economic strength, but rather is an instrument through which the potential of economic growth is directed and strengthened.

## **2 Indo-Pacific Economic Corridor**

### **2.1 Origins and Premises of IPEC**

The concept of the Indo-Pacific Economic Corridor (IPEC) should be seen in the wider context of U.S. foreign policy. In 2011, the Obama administration initiated the so-called pivot to Asia-Pacific (rebalancing), which is perceived as one of the most important strategic reorientation in recent U.S. policy. The growing importance of Asia as the world's leading economic center initiated a change in the perception of the region by the United States. Therefore the U.S. has introduced the concept of 'Indo-Pacific' as an area of cooperation in the fields of politics, security and economy. Additionally, the engagement of traditional American allies (Australia, Japan and above all India) in the development of the Indo-Pacific region concept is seen as a counterbalance to the growing strength and influence of China (Beeson & Lee-Brown, 2017, 196). Thus the concept of the Indo-Pacific should be considered as a U.S. led alternative to Xi Jinping's ‘China Dream’ and Belt and Road Initiative (Searight, 2018, 12). The change in the strategy of the United States was expressed in specific initiatives: in involvement in negotiating the Trans-Pacific Partnership<sup>1</sup>; in creation of New Silk Road Plan in July 2011 (Jia, 2017, 107) or in creation of the IPEC concept in 2013.

The emergence of IPEC is directly related to the recognition by the United States of the Pacific and Indian Oceans as a single and key maritime entity (Sundararaman, 2017, 27). It is not a surprise, as ca. 55% of world container trade and ca. 70% of ship-borne energy transport moves through waters of this region (Sundararaman, 2017, 28). In this context, the

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<sup>1</sup> In January 2017, the United States under the new administration of Donald Trump withdrew from the TPP agreement.

IPEC focusing on economic ties intensification between South and Southeast Asia is an instrument for the U.S. to build its influence in the region.

Among key activities under IPEC there is an advancement of regional economic connectivity to reach four main objectives (USAID, 2017, 4): to foster economic growth and regional trade in South Asia; to increase private sector competitiveness in the region by enhancing the business environment; to engage the private sector on economic issues, particularly regional trade in South Asia and trade between South and Southeast Asia; to encourage stronger economic integration between South and Southeast Asia, engaging with regional institutions and international financial institutions as appropriate. The IPEC's vision addresses physical infrastructure, trade integration, energy markets, as well as people-to-people relations. In each of these areas, there are large shortcomings, what is particularly evident in the area of infrastructure and trade integration. As a result, USAID, the U.S. State Department and Asia and Middle East Economic Growth Best Practices (AMEG) have allocated a modest budget of USD 1.86 million in order to develop the IPEC implementation in three phases, planned from 2015 to September 2017. The first phase consisted in analyzing the initiatives carried out to date, reviewing previous research and creating a base for further planning of IPEC. Non-tariff barriers (NTBs) were recognized as main obstacles to the development of trade between South and Southeast Asia. In the second phase, AMEG carried out an in-depth assessment of the results of the first phase, prioritized the NTBs, and identified the possibilities of IPEC in intensifying the intra-South Asia trade. In the third phase, in cooperation with private sector partners, specific initiatives were identified aimed at the elimination of NTBs identified in phases 1 and 2.

Each of the above-mentioned phases of the IPEC implementation ended with recommendations. One of the most important was the concept of creating a 'Borderless Alliance' – a private sector led and cross-border initiative designed to prioritize NTBs, identify information gaps, generate data needed to design and advocate for reform, and mobilize advocates across the region to hold governments accountable for facilitating increased trade (USAID, 2017, 27).

## **2.2 Trade integration**

Economic corridors, both of regional and national scale, contribute to greater trade integration, however, not necessarily in the same manner. In case of national economic corridors, trade in goods and services are facilitated within countries, whereas in case of regional economic corridors such effects may be observed across countries, enhancing

coordination of actions among them. In this context, trade integration would be higher within corridors that link locations with distinctive comparative advantages in production of respective outputs.

As Srivastava (2011, 10-12) indicated, economic corridors used to be launched as national/narrow, that involve construction or upgradation of a national transportation route, including development of investment areas, small and medium enterprises sector, urban and rural roads. Countries linked through economic corridors tend to invest in local infrastructure along the transportation route, trade facilitation measures and logistics services markets for the purposes of advancing cooperation toward establishment of cross-border economic zones.

Regional and broad economic corridors would enhance trade integration, improving an access to production networks expanding in East and Southeast Asia for external economic operators. In this context it is important to consider the role of physical connectivity within the networks, that enable fragmentation of value chain and spatial dispersion of production blocks among the countries at diversified level of income. An intra-industry trade induced by vertical specialization of respective locations has become an attribute of contemporary production networks in East Asia, engaged more and more frequently in back and forth and arm's length transactions in parts and components of machines in auto and electronics industry (Kimura & Obashi, 2011, 4-9). Noteworthy, South Asia, with special regard to India, tend to be underrepresented in regional production networks, therefore, economic corridors would enhance higher participation of this part of Asia in cross-border value chains.

As already mentioned, East Asian production networks concentrate in electrical machinery and equipment, including telecommunication, sound recording equipment and semiconductors, then, high and low volume products, that used to rely on air connectivity. On the other hand, transport equipment, contrary to electronics, is mainly high volume carried by road, rail and sea, therefore, establishment of economic corridors may serve as a trigger of trade facilitation and connect South, East and Southeast Asia.

As indicated by Shepherd and Wilson (2009, 367-383), trade flows in East Asia are particularly sensitive to transport infrastructure and ICT networks, including physical and soft logistics infrastructure, as well as the border costs. In this regard, countries with more liberal and open regulatory system, e.g. Japan, Singapore or Australia, possess an advantage over less developed countries with more restrictive regimes and markets, e.g. Malaysia, China, Indonesia, Thailand, the Philippines, and Viet Nam.

### **2.3 Physical connectivity within Southeast and South Asia**

Among the key strategic objectives in regards of connectivity improvement in Southeast Asia there are few areas that may be inscribed into the context of economic corridors. Firstly, there should be numerous initiatives aimed at development of sustainable private and public infrastructure, including proliferation of best practices on infrastructure productivity, deployment of smart urbanization models that identify key bottlenecks. Secondly, seamless logistics would be a goal, namely, lower costs and increased speed and reliability of cross-border value chains that constitute production networks. Thirdly, regulatory excellence would support trade integration and inclusive growth within corridors, when considering harmonization and mutual recognition of standards, conformance and technical regulations within key industries, reduction of non-tariff barriers in cross-border trade.

Among the trends what will likely impact physical connectivity of Southeast Asia there are, among others: the rise of middleclass and middleweights, the challenge of productivity and competitiveness, the skills challenges, disruptive technologies, as well as infrastructure opportunity and transformation of global flows. In the context of the latter two it should be noted, that region's annual infrastructure needs exceed USD 110 billion nowadays, whereas FDI to GDP ratio hasn't reached pre-1997 levels in most countries of the region. Currently, however, there is a spectrum of opportunities in regards of support infrastructure development, including the Asia Bond Fund (ABF), the Asian Bond Market Initiative (ABMI), the ASEAN Infrastructure Fund (AIF), the Asian Infrastructure Investment Bank (AIIB), the New Development Bank (NDB) and the expanded Partnership for Quality Infrastructure (PQI). Worth mentioning, even though public-private partnerships emerge these days to enhance private sector participation in infrastructure investment, still much has to be done in the fields of risk-sharing arrangements and project development. The transformation of global flows reflects the impact of technology development on international trade, including digital flows that increase in terms of importance year after year. Intra-regional flows of goods, services, investment may be triggered by establishment of ASEAN Economic Community in the late 2015, as well as mega-regional trade blocks under negotiation/ratification such as Regional Comprehensive Economic Partnership (ASEAN Plus Australia, China, India, Japan, New Zealand and Republic of Korea) and The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam). Importantly, there are numerous cooperation regional initiatives that promote both trade integration and physical connectivity, such as the Agreement on ASEAN Energy Cooperation, ASEAN transport

facilitation agreements, as well as sub-regional arrangements, e.g. Greater Mekong Subregion (GMS), Mekong River Commission (MRC), Brunei Darussalam-Indonesia-Malaysia-Philippines-East ASEAN Growth Area (BIMP-EAGA), and Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT). Aforementioned sub-regionalism should interact with ASEAN to encourage regional connectivity and trade integration.

South Asia used to face much more significant challenges in regards of connectivity than Southeast Asia. Among difficult issues there is an isolation of Pakistan, whether self-inflicted or regionally imposed, lack of understanding for multilateralism, strong nationalism induced by historic bilateral relations, e.g. Afghanistan-Pakistan, Bangladesh-Pakistan, India-Pakistan. Deep political entanglements fuelled mutual mistrust and aggressive behaviors instead of dialogue and compromise (Sharma, 2017). Therefore, initiatives in regards of physical connectivity under the auspices of South Asian Association for Regional Cooperation (SAARC) disappoint due to lack of political energy and legitimacy. On the other hand, many SAARC members seek for alternative frameworks of regional cooperation that exclude Pakistan, such as the Bay of Bengal Initiative for Multi Sectoral Technical and Economic Cooperation (BIMSTEC) and the Bangladesh, Bhutan, India, Nepal Initiative (BBIN), such as Bangladesh, Bhutan, India, Nepal, the Maldives, and Sri Lanka. As long as the second largest country of the subcontinent is isolated, whereas political rivalry tend to prevail over dialogue, progress in multilateral cooperation for the purposes of trade integration and improvement of physical connectivity in South Asia is unlikely.

### **3 Economic Implications of IPEC not only for the U.S.**

IPEC is based on a vision of establishing connected Indo-Pacific region, an epicenter of global trade and commerce, enhancing prosperity of nations and economic growth both in Africa, Asia and Americas, mainly through creating new energy linkages, opening up trade and transport corridors, connecting enterprises, streamlining customs procedures and border crossings.

For the United States, the IPEC project may bring geo-economic benefits resulting from the greater economic presence in the region. The economic rivalry with China requires taking pre-emptive actions. It is dubious whether the strongly promoted Indo-Pacific region will be an effective response to Xi Jinping's concept of 'China's Dream' and the Belt and Road Initiative, and whether it will maintain the current role of the United States in the Asia-Pacific region. This seems doubtful, because the weakest link in the U.S. concept is a lack of a clear

strategy for economic involvement in the region (e.g. withdrawal from TPP). At the same time, the United States can benefit at a microeconomic level, as U.S. companies with the appropriate knowledge and know-how in anticipated initiatives will have a privileged position and greater opportunities to join a process of the corridor building.

Worth mentioning, the IPEC project complements India's Enhanced Look East Policy, aimed at bridging South and Southeast Asia to converge Indian and Pacific Oceans. Among key stakeholders there are United States and India, however, countries like Bhutan, Bangladesh, Nepal and Sri Lanka might play an active role too. Myanmar, member of ASEAN, is the India's bridge to Southeast Asia. Thus, it is expected that due to IPEC India-Myanmar-Thailand Trilateral Highway will be accelerated, including upgradation of its key sections. Prospectively, trilateral highway might be extended to another lesser developed ASEAN members, namely, Cambodia, Lao PDR and Vietnam.

In case of Myanmar there is an important role of economic reforms that would integrate this country with other markets in South and Southeast Asia through trade flows and infrastructure. India, a key stakeholder, would probably focus not only on land infrastructure linking with Myanmar to reach ASEAN markets, but also address the problem of seamless connectivity within the country, for instance, through Kaladan Multimodal Transit and Transport project. In this regard, maritime connectivity between Southern India and Southeast Asia should be developed to complement current efforts aimed at connecting Northeast India with Myanmar, for instance, through India-Mekong Corridor and Chennai-Dawei corridor (Sundararaman, 2017).

Furthermore, there is an institutional context of economic cooperation under the auspices of IPEC, namely, India may be considered as the future member of Asia-Pacific Economic Cooperation (APEC) – a key Asia-Pacific forum for trade and financial regionalism, moreover, project stakeholders should establish an appropriate framework for Indo-Pacific Economic Corridor, free from mutual animosities, that exclude previously mentioned sub-regional initiatives e.g. BIMSTEC or SAARC. In this regard, both India and Myanmar may take the lead in the project.

ASEAN, on its side, is expected to expand already successful sub-regional initiatives such as aforementioned GMS proceeding with project of East-West Corridor which will link Da Nang in Vietnam to the port of Mawlamyine in Myanmar, as well as BIMP-EAGA and IMT-GT. Last but not least, Indonesia, the largest Southeast Asian economy, would probably develop own ocean strategy to link its eastern and western maritime extents to improve both internal and external connectivity.



## Conclusion

Indo-Pacific Economic Corridor is a far-reaching vision of bridging South and Southeast Asia to converge Indian and Pacific Oceans, support trade integration through infrastructure development to boost prosperity and inclusive growth. This, in turn, is expected to bring stability and security to this part of the world. Coordinated actions toward establishment of sustainable infrastructure and seamless logistics, accompanied by deregulation and liberalization of trade regulations would enhance expansion of value chains across the region based on distinctive comparative advantages and specializations of respective locations. It seems that a key to success would be a synergy between regionalism and sub-regionalism in both Southeast Asia and South Asia. In case of the latter, however, there is a huge challenge related to mutual animosities and mistrust that hinder pragmatic cooperation and development dialogue.

Among economic results of the corridor creation one can expect increases in incomes, reductions in poverty or alleviation of regional disparities. However, it should be remembered that any corridor in itself does not create an economic strength, but rather is an instrument through which the potential of economic growth is created. Additionally, the creation of trans-regional economic corridors may also encounter difficulties, as they may have a regionally differentiated impact. Another significant problem is the cost of the corridors. From the very beginning they require the creation of the physical infrastructure in the form of roads, railway lines, etc. According to estimates by ADB (2015, 14), the total cost of establishing road, rail, sea and energy trading connections between South and Southeast Asia was estimated at USD 73.1 billion, while in reality current allocation reached only about USD 8.4 billion (11.5%). This is another serious challenge that the Indo-Pacific Economic Corridor faces.

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