THE ECONOMICS OF TRADING BLOCS:
APPLICATION TO THE INDIAN OCEAN RIM

by

Alan Moody

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DEPARTMENT OF ECONOMICS

THE UNIVERSITY OF WESTERN AUSTRALIA
NEDLANDS, WESTERN AUSTRALIA 6907

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1. **Introduction**

What is a trading bloc? In its simplest form it can simply be a loose grouping of countries with some common cause on a particular trade issue - the Cairns Group of agricultural exporting nations led by Australia is a good example. At the other extreme lies full economic and political union - the eventual goal of the European Union.

In a world where the intrinsic economic benefits of free trade are generally recognised by most economists, why does the creation of discriminatory trade blocs seem to be increasing in popularity? To illustrate, the World Trade Organisation (1995) notes that between 1947 and 1994, the GATT was notified about 108 separate regional trading agreements.

The economic jury is still out on whether or not trading blocs as a concept are a good or bad thing - the welfare implications for both members and non-members can vary considerably due to factors as diverse as the form of integration, member coverage, and attitudes towards non-members. This stands in stark contrast to the situation prevailing before the 1950 publication of Viner's seminal exposition on customs unions, at which time there was general agreement that the creation of trade blocs was a definite step on the road towards freer trade - and thus something to be encouraged without question.

Why then do countries become members of trade blocs? Is it purely for economic gain? Is it an example of the herd mentality in operation - a fear of being the "odd one out". Indeed, as Roessler (1993) notes, the primary impetus for the creation of a Regional Integration Agreement (RIA) may not be economic at all, but political. In these instances, trade issues are only a peripheral consideration.

But in a situation where the underlying reasons behind the creation of an RIA are economic in nature, how do gains come about? Regionalisation itself has the potential to improve welfare in a number of ways. For example:

- increased production arising from specialisation according to comparative advantage;
- increased output arising from economies of scale;
- improvements in the terms of trade of the group with respect to the rest of the world;
- forced changes in efficiency arising from increased competition within the bloc;
- and integration induced changes affecting the quantity or quality of factor inputs, such as increased capital inflows or changes in the rate of technological advance.
The relative importance of each of the above points is likely to vary between individual RIAs', and it must also be remembered that RIAs' entail potential costs - both absolute and distributional.

*The Indian Ocean Rim*

Why apply the economics of trading blocs to a hypothetical grouping covering primarily developing countries spread over three continents and separated by an ocean? Are there *really* genuine economic gains to be made from such a grouping, or is the impetus for the grouping more political in nature?

The main aim of this paper is to evaluate whether or not a trading bloc (or alternatively, some other form of cooperation) would be a welfare enhancing development for the region.

Australia's interest in an economic grouping on the Indian Ocean Rim (IOR) is relatively recent, and can effectively be traced to the announcement of the Federal Government's "Look West" Strategy announced in August 1994 and continuing through to the International Forum on the Indian Ocean Region held in Perth in June 1995.
2. **Overview of the Indian Ocean Rim Economy**

2.1 **IOR Economies**

No one economy dominates the IOR, according to comparative studies undertaken by the Department of Foreign Affairs and Trade (1995b). While the Australian and Indian economies are the largest economies in the region by a clear margin, there are a number of other countries such as Indonesia, Thailand, Saudi Arabia, South Africa, and (at least until 1993) Iran with GDP levels of around the US$ 100 billion mark or more.

In terms of GDP per capita, Singapore and Australia stand head and shoulders above the other major economies, each exceeding US$10,000 per capita by a substantial amount. Saudi Arabia, a number of the Gulf States, the Seychelles and Mauritius also have relatively high levels of GDP per capita, ranging just under US$5,000 per capita for Mauritius, to well over US$20,000 for the United Arab Emirates and Kuwait.

As a percentage of GDP, investment is quite strong in all of the major IOR economies, with the exception of South Africa. The need for infrastructure provision should continue to drive investment in the majority of countries in the region - including South Africa - for the foreseeable future.

2.2 **Policy Reform Process**

The micro-economic reform process in Australia has now been running for a number of years, and has had not inconsiderable success in enhancing Australia's international focus and competitiveness. Perhaps the most pertinent facet of Australia's micro-economic reform process, has been its ongoing tariff reduction program. According to the Department of Industry, Science and Technology (1995), from 1996 Australia's general tariff rate will be at a maximum of 5 per cent (with the exception of the Textile, Clothing and Footwear sector, and the automotive sector) - relatively low by world standards.

Economic reforms in India are relatively more recent in nature, and can be said to have begun around 1991. Financial deregulation in India brought about by a crisis in foreign exchange reserves has been very successful, with the rupee approaching full convertibility and foreign exchange and foreign investment at very healthy levels. Further reform in cutting bureaucratic regulation and restrictive labour practices is needed, however, if India is to begin to approach the economic growth rates of nations further east.

The primary policy reform in South Africa, has of course been the abandonment of the policy of apartheid. While the economic position in South Africa has indeed turned around from one of recession, to one of moderate growth, there seems to be something of a "wait and see" policy being pursued by many foreign investors with respect to continuing political and economic stability within the country. So far at least, it seems that the ruling African National Congress is fully aware of the need for stability, and seems
to be steering a relatively responsible course, both politically and financially.

Many other African nations around the IOR have also adopted more rational economic policies and liberal political policies in recent years - though for many, this course of action has been taken somewhat reluctantly, induced through pressure by outside bodies as the IMF and the World Bank, as well as bilateral Western aid donors.

2.3 IOR Trade Profile

DFAT (1995b) has identified 47 littoral and hinterland countries that could lay claim to being part of the IOR. In order to roughly gauge the extent to which intra-regional trade occurs in the IOR, for a given country DFAT collated the number of other countries in the region for whom bi-lateral trade links were worth in excess of $1 million. The results of this study indicate that countries on the eastern rim (Australia, the ASEAN nations, India and Pakistan) have the widest trade penetration into other countries in the region. Most countries on the western rim of the Indian Ocean had significantly lower levels of linkages - with the notable exceptions of Zimbabwe and Kenya.

But at around 20 per cent, the level of intra-IOR trade still does not compare favourably with regions such as the Asia Pacific, where intra-regional trade is around the 66 per cent mark.

Trade by IOR Sub-Region

The impetus for export growth within the IOR group has come primarily from South East Asia. Total South East Asian exports to IOR countries topped US$50 billion in 1992, and the proportion of total exports destined for IOR countries has been relatively steady at around 28 per cent - 19 to 20 per cent going to other South East Asian countries themselves.

The next largest trade sub group within the IOR occurs in West Asia. This group exported $US 21 billion to other IOR countries - around 21.5 per cent of its total exports.

Australia and South Asia rank approximately equal third on the IOR trade league table. SAARC exports to other IOR countries reached $US 7.6 billion in 1992 - 23.1 per cent of total exports.

Australian exports to the region totalled around $US 7 billion in 1992 - approximately 18 per cent of total exports. The growth in the share of Australia's exports going to the region has been almost entirely driven by exports to South East Asia. For the 5 years between 1989 and 1993, exports to the IOR region grew by an average 14.7 per cent per annum.

Around 8.5 per cent of South African exports went to IOR countries, worth around $US1.2 billion in 1992.
Table 1

IIT Index of IOR Group With Other Regional Groups and Countries
Commodity total - SITC 5-8 at 3 digit level

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>14.96</td>
<td>19.22</td>
<td>26.57</td>
<td>34.65</td>
<td>45.14</td>
<td>39.42</td>
<td>163.50</td>
</tr>
<tr>
<td>India</td>
<td>6.89</td>
<td>8.06</td>
<td>12.85</td>
<td>28.19</td>
<td>31.24</td>
<td>29.10</td>
<td>322.35</td>
</tr>
<tr>
<td>USA</td>
<td>13.17</td>
<td>16.66</td>
<td>24.18</td>
<td>38.20</td>
<td>42.68</td>
<td>41.75</td>
<td>217.01</td>
</tr>
<tr>
<td>EEC-12</td>
<td>11.13</td>
<td>11.05</td>
<td>14.46</td>
<td>22.39</td>
<td>32.86</td>
<td>35.75</td>
<td>221.2</td>
</tr>
<tr>
<td>North East Asia</td>
<td>6.79</td>
<td>7.57</td>
<td>9.21</td>
<td>12.55</td>
<td>27.70</td>
<td>31.36</td>
<td>361.86</td>
</tr>
<tr>
<td>SA Cus. Union</td>
<td>29.64</td>
<td>35.36</td>
<td>28.49</td>
<td>34.50</td>
<td>34.68</td>
<td>34.39</td>
<td>16.03</td>
</tr>
<tr>
<td>ASEAN</td>
<td>47.67</td>
<td>62.87</td>
<td>69.75</td>
<td>79.56</td>
<td>82.94</td>
<td>82.97</td>
<td>74.05</td>
</tr>
</tbody>
</table>

Source: DFAT (1995b)

Though North and East African exports to the region are comparatively small, as a percentage of the sub-group's total exports they are quite high, at 30 per cent. Only 4.5 per cent of Indian Ocean island exports were directed towards IOR countries - though the IOR provided over 40 per cent of imports.

Trends in intra-industry trade

Table 1 shows the increase in the proportion of the IOR group's trade with other groups that can be defined as intra industry in nature since 1970.

Although it is evident that, historically speaking, the level of IIT both within the IOR and between the IOR and other regions has been very low, the proportion of trade that can be deemed IIT in recent times has increased significantly in all cases. A continuation of the tendency towards further liberalisation around the IOR should give further impetus to this trend.

2.4 Direct Foreign Investment (DFI)

In some circumstances, the creation of an RIA can lead to a surge in inward investment from outside the grouping - such as occurred from the USA when the European Community was formed, and from East Asia when the European "single market" agreement came into effect in 1992.
Balasubramanyam and Greenaway (1993) offer two potential reasons for this. Firstly, the investment flow may be motivated by a desire to avoid the group's tariffs, by producing goods inside the tariff boundaries rather than importing the goods directly. Secondly, the inward investment flow may be attracted by the enhanced growth prospects that arise from the larger market. The distinction is important, as investment motivated by tariff avoidance is likely to reinforce trade diversion, whilst investment in response to more dynamic growth opportunities associated with the larger market is likely to bolster trade creation.

DFI has undergone a somewhat radical image change in many developing countries in recent times. What was once seen as an almost sinister extension of economic control by western multi-nationals, is now recognised as a very effective conduit for importing technology and expertise, and for enhancing development potential.

Foreign portfolio investment, too, has been important in financing development in a number of countries. Within the IOR region itself, the limited data available suggests that there has been a discernible increase in the level of DFI flowing from the more industrialised, and larger IOR countries, to less industrialised ones. Intra-IOR DFI sources include Singapore, Malaysia, Australia, India and Indonesia. But even so, for the foreseeable future, the most important sources of DFI inflows are likely to remain outside the region.

Table 2 gives a historical overview of the level of net direct foreign investment for selected countries around the IOR. India, Indonesia, and Thailand in particular, have reformed and streamlined their DFI regulatory regimes recently, and have seen the levels of both DFI and portfolio investment that they receive rise markedly in response. Malaysia, Singapore, and Australia have seen their already substantial (in regional terms) net DFI inflows rise significantly over the time period in question. There is also potential for the oil rich states of West Asia to increase their DFI in the region if economic integration proceeds.

At the other end of the spectrum, the haemorrhaging of capital from South Africa that accompanied the last years of apartheid is clearly evident - as is the slowing of this outflow that took place when the momentum towards democracy gathered pace in the nineties. Given a continuation of relative political stability, it is reasonable to assume that South Africa can expect the substantial turnaround in its DFI flows to continue.

While the rest of Africa has not experienced the same DFI outflows as South Africa has recently, the primary reason for this is that the stock of DFI in the majority of these countries was negligible to begin with. Even in Kenya, DFI has dwindled to a fraction of its former level as first-world investors have become increasingly disillusioned with the political instability and economic mismanagement that has become endemic on the African continent, and turned their attention towards less risky
investments in Asia and Latin America. On a brighter note, however, the Indian Ocean island economies of Seychelles and Mauritius have consistently attracted solid levels of DFI relative to their size, reflecting the much more international focus their economies have, with tourism, export processing, and sugar all important segments of their economies.

Table 2

<table>
<thead>
<tr>
<th>NET DIRECT FOREIGN INVESTMENT ($USm)</th>
<th>1980</th>
<th>1985</th>
<th>1990</th>
<th>1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>1,409</td>
<td>183</td>
<td>5,953</td>
<td>4,641</td>
</tr>
<tr>
<td>Iran</td>
<td>-</td>
<td>-</td>
<td>0</td>
<td>-</td>
</tr>
<tr>
<td>India</td>
<td>8</td>
<td>160</td>
<td>112</td>
<td>390</td>
</tr>
<tr>
<td>Indonesia</td>
<td>180</td>
<td>310</td>
<td>1,093</td>
<td>1,774</td>
</tr>
<tr>
<td>Malaysia</td>
<td>934</td>
<td>695</td>
<td>2,332</td>
<td>4,469</td>
</tr>
<tr>
<td>Pakistan</td>
<td>68</td>
<td>78</td>
<td>200</td>
<td>562</td>
</tr>
<tr>
<td>Singapore</td>
<td>1,138</td>
<td>809</td>
<td>3,911</td>
<td>4,288</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>43</td>
<td>24.8</td>
<td>42.5</td>
<td>121</td>
</tr>
<tr>
<td>Thailand</td>
<td>187</td>
<td>162</td>
<td>2,303</td>
<td>1,979</td>
</tr>
<tr>
<td>Kenya</td>
<td>77.9</td>
<td>12.7</td>
<td>57.1</td>
<td>6.4</td>
</tr>
<tr>
<td>Lesotho</td>
<td>4.5</td>
<td>4.8</td>
<td>17.1</td>
<td>2.7</td>
</tr>
<tr>
<td>Madagascar</td>
<td>-</td>
<td>-</td>
<td>22.4</td>
<td>21.2</td>
</tr>
<tr>
<td>Mauritius</td>
<td>1.2</td>
<td>8.2</td>
<td>40.4</td>
<td>-28.6</td>
</tr>
<tr>
<td>Mozambique</td>
<td>0</td>
<td>0</td>
<td>9.2</td>
<td>25.3</td>
</tr>
<tr>
<td>Oman</td>
<td>98.4</td>
<td>161.3</td>
<td>141.0</td>
<td>58.8</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>-3.2</td>
<td>0.5</td>
<td>1.9</td>
<td>-</td>
</tr>
<tr>
<td>Seychelles</td>
<td>5.7</td>
<td>1.1</td>
<td>19.4</td>
<td>16.3</td>
</tr>
<tr>
<td>South Africa</td>
<td>-765</td>
<td>-497</td>
<td>-5</td>
<td>-5</td>
</tr>
<tr>
<td>Swaziland</td>
<td>17.5</td>
<td>8.9</td>
<td>19.3</td>
<td>42</td>
</tr>
<tr>
<td>Tanzania</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>15</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>1.6</td>
<td>2.9</td>
<td>-12.2</td>
<td>15</td>
</tr>
</tbody>
</table>

Source: World Bank
3. **Prospects for Economic Cooperation on the Indian Ocean Rim**

3.1 **The Indian and Arab Diaspora**

While it is evident that economic, political and cultural linkages between IOR countries do not currently exist to the same extent as those between groupings of purely industrial countries such as the EU, NAFTA, or CER, the region does have at least one binding thread: the Indian - and to a lesser extent, Arab - diaspora. Both of these groups have maintained a cohesive sense of community in their adopted countries, and in many cases occupy key positions in the local economy.

While the Arabic diaspora is (apart from their home countries) more or less restricted to coastal east Africa, the Indian diaspora is much more widely spread and much more numerous.

It could be hoped that as intra-regional trade in the region grows in the future, the Indian and Arabic diasporas' will begin to play a role similar to that currently undertaken by the overseas Chinese in east and south east Asia - that is, as providers of investment and facilitators of trade.

3.2 **The Economic Outlook**

It seems likely that given the relatively small size (in world terms) of the IOR economy, the major determinants of growth for the region will continue to stem from the rest of the world for the foreseeable future.

Nevertheless, there are definite signs that the level of economic interdependence among IOR countries has been increasing in recent years. As shown in Chapter 2, the volume of trade which IOR countries conduct both with each other and the wider world has increased markedly. The proportion of this trade that has been intra-industry in nature has also risen steadily in most cases.

The recognition of the need for economic reform in south Asia, along with the increasingly widespread acceptance of IMF Structural Adjustment programmes in Africa presage a region wide lift in economic efficiency and transparency. Coupled with the political reforms in South Africa, this has transformed the investment climate in the region, and this in turn is being reflected in the upturn in DFI flowing into the Indian Ocean Rim.

3.3 **Developments from the Perth IOR Regional Forum**

The Perth IOR Regional Forum was a second-track (non-official) meeting that took place in June 1995, with the aim of promoting economic cooperation in the Indian Ocean region. Participants at the Perth meeting resolved to set up several non-government organisations such as the Indian Ocean Rim Business Forum and the Indian Ocean Research Network. Ongoing working groups were also established to look at
areas such as educational cooperation and environmental matters. The forum undertook to meet again in New Delhi, in December 1995.

3.4 Does the IOR meet the requirements for a successful RIA?

Economic size

At around 47, the number of potential members of an IOR economic grouping compares well with other successful groupings such as the EU, NAFTA and APEC. But in terms of economic "clout", the IOR is not in the same league as most of the other groupings. As a result, the "size" effect of any discriminatory integration scheme is likely to enhance trade diversion.

Protection levels

For many countries in the region, pinning down prevailing protection levels is an impossible task, with many governments reserving the right to vary tariffs by substantial amounts at their discretion. In general terms, the degree of openness ranges from one of the most open economies in the world in Singapore, to the much more restricted markets of South Asia and Africa. Protection throughout the region could be said to be relatively high in world terms. It is extremely doubtful, however, that countries such as Singapore and Australia would countenance any upward movement in their tariff levels as part of a regional integration initiative.

As a result, any move towards integration through preferential tariff reductions around the IOR is likely to involve an overall drop in average protection levels. As such, it would tend to enhance trade creation.

Trade expansion

Given that the probability for trade creation generally rises with the level of economic competitiveness of its constituent economies for developed countries, and rises with complementarity for developing countries. As the IOR encompasses both developed and developing nations, the potential for trade expansion is not immediately clear. On closer examination, however, the majority of countries are at a lower level of development, and in addition, industrialised countries such as Australia and South Africa have trade profiles more usually associated with developing, rather than a developed countries (i.e primary commodity based). On balance, it must be said that the probability of intra-regional trade expansion taking place on the scale of that experienced in Europe, North-America, and even the Asia-Pacific, is not high.
Differences in cost structures

Whilst actual comparative data is difficult to obtain, there is no doubt that where IOR countries experience industry overlaps (i.e. have the same industry type in more than one country), substantial differences occur in cost structures. But in most instances, the lowest cost source will still be outside the grouping, raising the chances of trade diversion occurring.

Geographic considerations

The idea that the IOR could be thought of as a “region” insofar as economic terms are concerned, would have seemed nonsensical just a few short years ago. Yet the advent of a successful ocean-spanning economic cooperation body in the form of APEC has made the idea of a similar grouping in the Indian Ocean more realistic.

But a number of economists would discourage the formation of discriminatory trade groupings between geographically distant members, on the grounds that this type of grouping is more likely to be trade diverting. Geographically close neighbours are thought to be more "natural" members of a trading bloc. Two arguments are usually used to support this statement. Firstly, that an RIA is more likely to be trade creating if the members' trade with each other is a relatively high proportion of their total trade, and secondly, that geographically close countries generally trade more with each other than they do with more distant countries.

But Bhagwati (1994) notes that this will not be the case in every situation. While it is certainly more likely that the first argument will hold, differences in substitution elasticities may very well dictate otherwise. So too, while the second argument may seem intuitively reasonable, it is not supported by any conclusive empirical evidence.

Other considerations

The dynamic effects of integration around the IOR, are by their very nature difficult to estimate. For example, while in some sectors greater competition would result in greater specialisation and more efficient resource allocation, it is doubtful whether the scope exists for this to be a widespread phenomena. The relatively small size of the grouping also mitigates against any substantial gains through economies of scale, or through favourable shifts in the terms of trade.

Many of the less developed economies in the region would gain substantial benefits through positive changes in factor productivity brought about by means such as more integrated capital markets, greater openness to technological innovation, and more opportunities to enhance the productivity of human capital through skills transfers and educational exchanges.
3.5 Prospects for Formal Economic Integration on the IOR

It seems likely that the level of economic interaction between IOR states should continue to increase in the future. Is it worthwhile formalising the process through the creation of an economic grouping around the IOR?

The evidence indicates that a regional dynamic is beginning to develop in the eastern section of the IOR, and there are reasonable prospects that this may soon extend to South Asia. The prospects for integrating West Asia and Africa into this regional dynamic is somewhat more problematical, however. Nevertheless, on the evidence of the arguments presented so far, it seems that the creation of a discriminatory trading bloc around the IOR would in all probability be trade diverting in nature. Most countries would end up discriminating against their existing major trading partners, which would of course be an unequivocal mistake. Yet this certainly does not rule out cooperation based on non-discriminatory principles.

Open Regionalism - The APEC Example

Another option worth examining, is open regionalism. Arndt (1994) describes open regionalism as outward-looking by nature, and less discriminatory than more formal types of RIA. Open regionalism is much more likely to enhance the multi-lateral trading system than more formal integration types such as preferential trading arrangements and customs unions.

The APEC grouping is a good example of an RIA based for the most part upon open regionalism concepts. As Elek (1994) notes, one of the most fundamental tenets of APEC, is that the liberalisation of regional trade should be promoted so long as it conforms with GATT requirements, and does not injure non-member countries. This last caveat is unique among RIA's, and holds the key to APEC's support for the multi-lateral trading system.

In general terms, open regionalism such as that practised by APEC, allows progress on the trade liberalisation front to proceed faster than is the case under the WTO, while still being in accordance with WTO principles. Complex larger issues can be separated into smaller, more manageable issues, and an incremental consensus approach to decision making adopted. If consensus on any particular area cannot for some reason be reached, then it is possible for those members who do reach agreement to move ahead, without excluding other members from implementation at a latter date.

But even though unilateral liberalisation has undoubted benefits for the liberaliser, there is still a political stumbling block to overcome. There is often resentment to allowing third countries to benefit from another nation's liberalising effort, if that country is not prepared to liberalise itself - the so-called "free rider" principle. Nevertheless, it would still be possible to liberalise in a non-discriminatory fashion in sectors where most of the benefits would accrue to participants - such as situations where there is a large degree of complementarity among member countries, or where resource endowments or transport costs limit effective competition from outside the grouping.
4. **Conclusions and Comments**

We have already seen in the previous Chapter, that discriminatory integration is not a realistic option for the IOR. The economic focus of the majority of economies within the region will continue to be outside the IOR itself for the foreseeable future, and the trade profiles given in Chapter 2 confirm this. Multi-lateral liberalisation under the auspices of the WTO has much more to offer the IOR region, than a premature discriminatory grouping of countries, most of whose primary trade partners remain outside the grouping. On the other hand, we have also seen how a non-discriminatory grouping seems to be working successfully in the geographically far-flung Asia-Pacific region.

What then, is the best way ahead for the Indian Ocean Rim?

**Cooperation Principles**

Without doubt, the best way ahead for the IOR is continued multi-lateral trade liberalisation under the auspices of the WTO. But given that this has proved to be a slow and at times tortuous process, there is considerable scope for cooperation and integration to take place around the IOR that conforms to the principles of open regionalism.

**Practical Implementation**

As always, the implementation of broadly based liberalisation principles may prove a somewhat difficult task in practice.

One potential problem raised at the time of the forum in Perth concerned the large number of countries involved (possibly 47). It was felt in some quarters that this "scatter-gun" approach would inhibit flexibility, making progress towards agreement on worthwhile initiatives more difficult to achieve. Perhaps one way around this may be to institute a "G7" or "G10" of the Indian Ocean Rim, with membership subject to some form of economic qualification criteria.

The attempt by the Australian Foreign Minister, Gareth Evans, to link security issues to the economic ones under discussion, could also act as a distraction. This is not to say that security issues are less important than economic ones, but linking them will definitely slow progress on the economic front.

As a first step towards cooperation, it may be advantageous to begin moves towards greater cooperation in relatively "easier" areas such as telecommunications, customs cooperation, human resource development and tourism.

There is no doubt that trade liberalisation and increasing economic interdependence is in the interests of all IOR countries. But for many of the poorest countries, the bureaucratic costs of supporting its share of
the secretariat costs of a formal economic grouping are likely to be prohibitive. As a possible alternative, it would be far more cost effective for these countries to "hitch a ride" on the back of their nearest large neighbour.

The framework to achieve this is already substantially in place. Perhaps the most cost-effective way to enhance regional development and trade flows in the IOR is to set up a grouping based on pre-existing economic groups, rather than set up a new grouping from scratch. In other words, the members of the IOR regional grouping would be the East African Community, the Southern African Development Community, the Gulf Cooperation Council, the South Asian Association for Regional Cooperation, the ASEAN Free Trade Area, and Australia (or perhaps even the CER grouping). Larger countries may also choose to become members in their own right, in addition to maintaining membership through their sub-regional grouping. A good example of this type of arrangement that is already in operation, is the WTO, where both the EU and its constituent nations are members.

This scenario has the advantage that the extra costs of bureaucracy would be minimal, while still allowing all individual countries to participate through their sub-regional groupings. This would also allow the poorer countries to focus more sharply on developing inter-relationships in their immediate geographical region. For example, their seems little doubt that the potential for trade over the short to medium term is much greater between Mozambique and South Africa, than between Mozambique and Bangladesh. It makes sense then, for Mozambique to direct its meagre resources towards building trade links with South Africa, rather than with countries on the other side of the ocean.

South Africa, on the other hand, is, large enough and (in part, at least) developed enough to benefit from enhanced trade links around the IOR. Mozambique would still benefit indirectly from the wider regional grouping through SADC's membership of the IOR body. As the IMF (1995) observes, Africa's integration into the global economy is vital to its long term future - the approach outlined here offers a manageable and cost effective route to this end.

This is not to say that direct involvement in an IOR peak regional organisation by smaller countries should be ruled out completely. An umbrella organisation could be set up to cover a number of subordinate, topically-based forums to which the countries of the region could opt into or opt out of as they saw fit. This would minimise the cost and maximise the benefit for the poorer countries. An expanded brief in addressing economic cooperation issues may allow IOMAC to fulfil this role.

Even though the current linkages around the IOR are not strong relative to many other regions, the potential remains for these linkages to develop over time. Therefore, specific sectoral cooperation, standards harmonisation, and informational exchange would all be fruitful avenues for economic cooperation.

While the main priority for countries on the eastern rim will undoubtedly remain with APEC, their dual membership in an IOR grouping would allow the nations of Africa and West Asia to link themselves with
the dynamic Asian region indirectly - in effect gaining a type of non-voting, de facto membership of the APEC organisation itself.

Last word

In the final analysis, there is no doubt that comprehensive liberalisation on a global scale is preferable to any conceivable arrangement of regionalised trading blocs. Even the most trade creating of RIAs' are essentially interim, second-best solutions. In this respect, the long term goal of any RIA should be as stated by "The Economist" (Sep 16th 1995, p29): "Like the Marxist state, they should be committed to withering away."
References


The Economist (16/9/95). “Regionalism and Trade”.


