

Vision 2020 – ADB's Trade and Investment Strategy – and how to create spillover from India's Northeast

Achievements & Future Direction

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1. **The Vision 2020 Analysis by Dr. Govinda Rao.** The Northeast region of India has political borders drawn that cause *structural retrogression*. This means
 - a) poor penetration of the markets (internal and external) and hence the majority of the population stays out of the market;
 - b) development not based on the comparative advantage of the region;
 - c) a failed planning process that has not strengthened forward and backward linkages, and not increased (labor) productivity and competitiveness; and
 - d) it means a persistent climate of insurgency which has created an inhospitable investment climate particularly detrimental to formal small and medium enterprises (SMEs).

A Way Forward Part I (10 March)

2. **Responding to a and b.** ADB India and South Asia regional operations in trade and investment related policy reform, infrastructure investment, regional integration and connectivity, capacity building for labor and for small and medium enterprises (SMEs), dovetail the components of India's export strategy and of the North Eastern Region Vision 2020. Provision of trade finance is a critical component of ADB's comprehensive approach to trade.
3. A key aspect of trade opening is tariff reforms and customs reform and harmonization. ADB has invested in tariff reforms and customs infrastructure along the India Nepal border. ADB is to undertake customs harmonization, and harmonization of product standards among the four countries of the South Asia Subregional Economic Cooperation (SASEC). Trade development particularly in the cross border or global sense has not been the explicit central objective of ADB in its India level operations. However recent efforts at mainstreaming trade development, and emphasis on mobilizing Aid for Trade, will bring into sharper focus the macro spillover benefits for trade from the combination of a diverse set of operations, particularly through enhanced industrial, agriculture efficiency, and trade infrastructure development in India. Several trade related investments in these sectors are planned for India (see table 1). Many private sector infrastructure and manufacturing projects financed by ADB have also had important implications for improving supply capacity for trade. Combining infrastructure, trade facilitation and reform, sector capacity building along supply and value chains, crucial benefits emanating from economic corridors are realized.

Table 1: ADB-FUNDED PROGRAMS/PROJECTS

| Project or TA | Year | Implemented, under implementation and planned (\$million), 2001–2010 | | | |
|---|------|--|------------|--------|-------------|
| | | Reform | trade fac. | infra. | supply cap. |
| SASEC RETA 6010 | 2001 | 0.5 | | | |
| SASEC RETA 6187 | 2004 | | 0.5 | | |
| SASEC RETA 6297 | 2005 | 1.0 | | | |
| RETA 6282 East and South Asia Coop | 2006 | | 0.5 | | |
| RETA BIMSTEC | 2007 | | 0.7 | | |
| BIMSTEC III | 2010 | | 1.0 | | |
| SASEC IV | 2008 | 1.0 | | | |
| SASEC V | 2010 | 1.0 | | | |
| Trade Fac. Capacity and WTO | 2007 | | 0.5 | | |
| PPTA SASEC transport log. and trade | 2007 | | 1.0 | | |
| ADTA SASEC transport log and trade | 2008 | | | | |
| SASEC transport log. and trade | 2008 | | 80.0 | | |
| RETA Subreg trade-rel infrastr. | 2008 | | | 0.7 | |
| Operationalization fo a Strategic Framework for Action on Trade Facilitation and Investment | 2009 | | 1.5 | | |
| SASEC info highway | 2008 | | | 20.0 | |
| SASEC rural broadband | 2008 | | | | 1.0 |
| SASEC rural broadband | 2009 | | | 200.0 | |
| SASEC tourism dev. | 2008 | | | | 150.0 |
| SASEC value chain investment | 2009 | | | | 1.0 |
| PPTA 4347 NEP Transport Connectivity Sector Project | 2004 | | | 0.6 | |
| SAARC RETA 6112 Subregional corridor oper. Eff. | 2003 | | 0.3 | | |
| RETA 6087 SME Growth and Development in South Asia | 2002 | | | | 0.8 |
| IND West Bengal North South Corridor Dev. | 2001 | | | 1.3 | |
| IND TA 4814Agribusiness infrastr. | 2007 | | | | 0.3 |
| IND SME Export (Exim –Nonsovereign) | 2008 | | | | 150.0 |
| IND PPTA Northeast trade and investment creation | 2004 | | | | 0.65 |
| IND Northeastern Trade and Investment Creation Initiative | 2008 | | | | 150.0 |
| IND Northeastern States Roads | 2008 | | | 300.0 | |
| Sum | | 3.5 | 86.0 | 522.6 | 453.75 |

4. ADB by its Charter is mandated so support regional cooperation in South Asia. Beyond the India country program, ADB has recently laid the ground for a broad range of large and quite significant investment operation in the region. ADB's Multi Modal Transport Development regional technical assistance (RETA) to the South Asian Association for Regional Cooperation (SAARC) has drawn up investment opportunities for all the major existing and emerging economic corridors linking the South Asian economies of overseas markets. Under SASEC,

ADB provided TA that established a trade and investment working group and has followed up with assistance for establishing other working groups for transport, information technology (IT) and tourism development. In SASEC, the planned operation includes support for transport logistics and trade facilitation which will be particularly beneficial for connectivity in the border areas between Nepal, Bangladesh, Bhutan and eastern India.

Spillover and the tangible and intangible dimensions of the global value chain

5. Regional cooperation is important for DMCs to reap economies of scale, positive network and inter-country externalities, from mutualization of risks and diffusion of skills, as well as from increased investment, financial deepening and trade facilitation. Solutions to reduce diseconomies of scale may involve harmonization, mutual assistance among authorities, coordinated investment along globally linked supply and value chains, mutual recognition of rulings (e.g. for transit operations) and certification and testing. Setting up regional accreditation bodies or opening regional markets for accreditation bodies in a way that exploits economies of scale can be the way to provide affordable testing to LDCs. Backbone and hub services provide crucial inputs in economic transactions and similarly provide the way to exploit economies of scale: finance and insurance, technology facilities and networks, common regulatory levels, transport and logistics, handling, measurement, and communication lines. The high cost arising to investors and traders from the differences among national economic systems in a region or sub-region can be better addressed at the regional level because of the political economy and the complexity of arrangements. Regional trade agreements which are well designed for the implementation of regional tools facilitating trade in the manner just described can deliver on trade facilitation public goods. ADB is well-placed to handle political economy issues in a neutral way, and to deal with complexities of regionalism in a carefully sequenced approach.

6. The Integrated Value Chain Analysis (IVCA) is employed to select sectors and products that gain successfully access to lucrative markets. IVCA is a channel mapping process which relies on intensive consultation with all players that make up a global value chain from the point of product and service conception and the location where the basic inputs are produced to the ultimate point of consumption. In this way the process highlights all the underlying patterns of inputs, constraints and bottlenecks, the competitive advantage a producer has, and how the producer can realize the competitive advantage by removing constraints and getting access to the market in the face of competitors. It traces the path of all value adding and non-value adding by specific actors associated with the production of a good or service, and it approximates costs involved at each stage. IVCA thus benchmarks one producer against another, as well as of production activities across regions and countries. With extensive fieldwork necessary, a good channel mapping exercise mirrors realities facing local enterprise.

7. The selection of specific products for analysis is an important aspect of a successful IVCA. The reason is simply that the product chosen is really a proxy for the entire sector. Although the results for different products within a product cluster will often vary, experience suggests that the policy, legal and market distortions a product cluster faces and the impact these distortions have on the competitiveness of players along the supply chain vary only marginally. Therefore the final value chain analysis will look very similar for major products across the spectrum of product cluster.

8. This figure below illustrates that the value chains from the NER can extend into neighboring economies and would overlap at various points or clusters (thus forming a lattice) where common facilities/infrastructure would be utilised by these value chains to get integrated into the global economy.

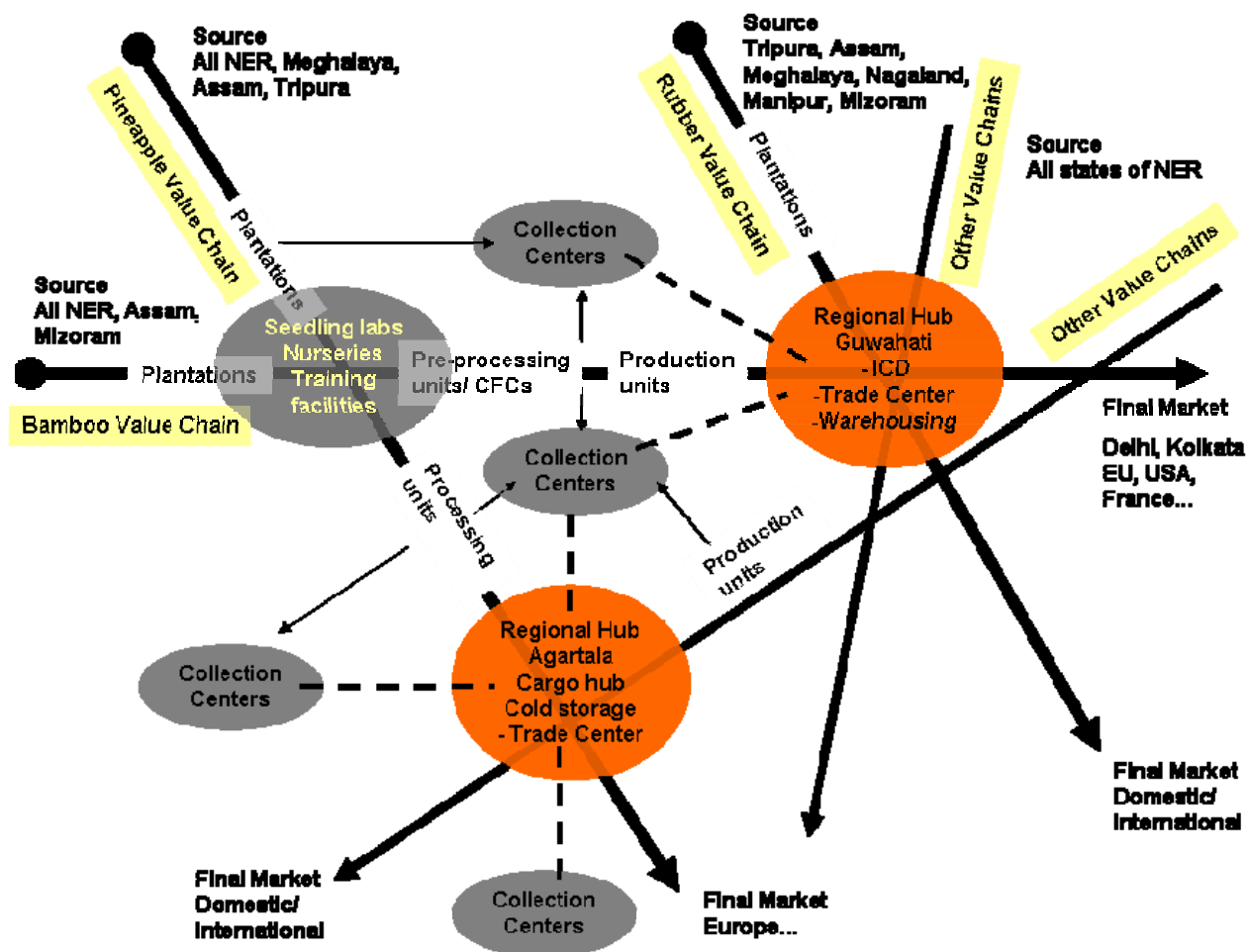


Figure 1: Value Chain in the Northeastern Region

9. The above figure shows a hub and spoke model with interaction between various value chains at different levels. At farm level and pre-processing level, common product specific infrastructure such as seedling labs, commercial plantations, training facilities, common facility centers would be required. Post-harvest activities would include processing and packaging and would have product-specific requirements. There could be centers with some post-harvest activities such as cold storage, warehouse, transportation facilities which could form 'collection points' for various products. These points would be important links to the regional hubs that could be developed at major cities such as Chittagong, Guwahati and Agartala which have better connectivity to the outside world through Cargo hubs/ Inland Container Depot (ICD), etc. At these cities, trade marketing and facilitation centers could be developed which will have facilities for e-auction and trading with adequate ancillary facilities such as storage, post-harvest processing and packaging, transportation, etc. Produce from these hubs could then proceed to final domestic and international markets.

Catching up with the rest of the country

10. **The Vision 2020 Analysis by Dr. Govinda Rao.** The NER is falling behind relative to the rest of the country which is growing rapidly at about 9 percent, while the Northeast has been growing at less than half the rate. NER growth largely results from growth in the public services sector, due to heavy Central Government spending. Private sector investment and growth is lagging. According to the vision 2020, the NER growth needs to accelerate beyond 9 percent growth until 2020.

11. Higher growth and higher incomes for the NER requires chiefly:
- a) creation of non-farm employment and economic activity in rural areas, and in accordance with NER comparative advantage;
 - b) capacity development in public and private institutions, and for the people of the region;
 - c) creation of a secure environment for development, involvement of people in the direction of their own development, ensuring property rights and corruption-free administration;
 - d) investment.
12. **Responding.** Accelerating the NER economy requires a significant rise in competitiveness. Increased competitiveness of the region results in higher economic growth with employment creation. According to an experiment with evolutionary, spatial and trade network model, growth rate accelerates to the national average from 3.5 percent with investment. This also results in a doubling of formal employment by 2015 in areas with a critical mass of structural change. Due to investment, transaction and transformation costs for trade are lower by up to 50 percent. The model highlights that heavy investment in transport infrastructure pays off only with the co-investment from the trade and investment creation initiative. In the model the investment is shown to be of sufficient scale to make the impact without overwhelming limited absorptive capacities of the institutions. Traditional equilibrium and macroeconomic models will not reveal this important interaction of investments for superior overall economic benefit, and located in particular areas of the region. The traditional modeling approach makes both the transport investments of \$1 billion and the \$500 million trade investment marginally viable, without recognizing the large additional agglomeration and scale externalities from co-investment.

A Way Forward

Part II (11 March)

A story to be told -- What the business people in the Northeastern Region may do as a priority to achieve economic success in collaboration with ADB, and in the context of the Vision 2020.

13. At this point it is effective to take the point of view of a business person that recognized in order to successfully access markets for growth and for generating employment in the agribusiness areas of the Northeast the business has to become part of a fully complete and functioning value chain. However, the entrepreneur can do so only when there is a mechanism that can coordinate among all providers of value chain elements that lie outside his sphere of influence. So before any Northeast SME can successfully join a value chain, there has to be a mechanism in place which can determine what a value chain is, who is part of it, and to what lucrative market it links. We will have to get to this mechanism in the sections below, so for now it is assumed that this mechanism is in effective operation.
14. Now with the help of the institution a set of Integrated Value Chain Analysis has been done, and the business person is assured that he is to be integrated into a global value chain, the **bamboo-rhino** value chain, with a market size estimate at \$7 billion and growing, and the NER potential in that market is to garner at least 1 billion market share in about 10 years.
15. However, the analysis also determined that at present the SMEs and the entrepreneur do not and cannot sell their product beyond a protected local market. The international competitors (who cannot access the remote local markets of the NER) produce more efficiently and can sell to the lucrative customer of bamboo-rhinos at \$20 per unit, whereas the Northeast entrepreneur sells at \$40 per unit. The entrepreneur asks, why this is the case, and he gets the

full explanation from the IVCA analysis that has been prepared by the integrated institution with the help of a team of local and international bamboo-rhino value chain experts.

16. Raw material cost for bamboo-rhinos in NER is 2 \$ higher than with competitors. In NER bamboo is grown in clumps and not thinned so that rhinos can feed efficiently and without hindrance. Rhino-bamboo stuffing is inefficiently harvested. Higher adhesive and chemical costs to treat the shell for bamboo-rhinos is 1 \$ higher in comparison. Another added cost of \$2 is the low labor productivity due to lack of commercial training, but also because the raw material processing technology and machinery is outdated. The lack of growth and export zones which cluster a set of exporters around an efficient location with efficient availability of electricity, maintenance and services, water and other direct costs adds an additional non-competitive cost of production of \$4. This is also because raw materials are inefficiently shipped, and pre-processing and processing units are inefficiently located in terms of logistics, adding another \$2. Inefficient market access, quality control, and marketing adds another \$2 to higher price compared to competitors, and then the inefficiencies in packaging and in containerization, and in transport to and through ports that afflict the NER take another \$5 toll.

17. Now the IVCA analysis and coordination mechanism will submit to the entrepreneur the team of organizations and of other players, in the Northeast, in India, and in overseas that will re-engineer the deficient value chain into one that will produce quality, high standard, environmentally friendly, bamboo-rhinos at the competitive world market price of \$20. To improve planting, feeding and harvesting practices and technology for bamboo-rhinos, the National Mission on Bamboo Application, the Bamboo Development Agency, and the Cane and Bamboo Technology Centre, as well as the Indian Rhino Foundation need to be involved. Agribusiness extension agencies as well as tribal councils will be mobilized as well. The entrepreneurship development institute will undertake management and production training for business people, employees and workers.

18. On the other end of the value chain, a so-called lead-firm that is a major wholesale player in the international market will be attracted to take off a guaranteed quantity of quality certified bamboo-rhinos at the international take-off price under a multi-year contract. A quality certification body will play an important role to guarantee the quality of inputs to ensure contract enforcement. Exim Bank can help with some export-finance overseas for the international wholesalers to expand product shelf space in different locations, and close to the key shopping malls in Singapore, Japan, the US and Europe.

19. And other organizations in the middle of the value chain need mobilization, for instance CONCOR, port authorities, inland container depots, warehousing association, and so on.

20. The NER will have to attract a substantial number of investors and link them backward to productive enterprises as input-clients in order to assure operational feasibility. This is where Exim Bank India can play an important role, also with trade and project finance. The most important task for States is to let goods and services flow along the value chain, and from the region's SMEs and their agribusiness suppliers to and from investors.

21. Pilot States Assam, Mizoram and Tripura get involved in the design, development, and investment in value chains on a pilot basis. Very importantly this means participation in the TA Board and in the Oversight Committee on the public sector infrastructure side, and as partner with investors such as Exim Bank and other private sector players. It is a co-operation game for all to win together.

22. The capacity building grant TA from ADB, will aim at (i) assisting the SMEs/ exporters in NER to access finance through enhancing capacities for undertaking financial assessments; (ii) assist the State and Federal Governments in undertaking necessary policy reforms and develop

an enabling environment for trade, and to establish trade infrastructure investment feasibility; (iii) develop adequate resource material for value chain development feasibility in the NER; and (iv) overcome market access barriers such as access to information and business networking by providing a window for marketing the products.

Figure 2: Preliminary Business Plan Scenario: Value Chain interventions

| Value chain interventions | | |
|--|--|---|
| Product-specific interventions | Public interventions (Infrastructure & Policy) | |
| Plantations ~3000 ha Capital Cost: \$441700 <div> <div>IRR (15 yrs) 18%</div> </div> | Common Infrastructure -Feeder Roads 230 Km ~\$86 Million -Power 9 MW ~\$11 Million -Inland Container Depot ~\$9.5 Million -Trade facilitation Centers ~\$17 Million -Cold Storage warehouse ~\$0.5 Million | Soft Interventions -Capacity development ~\$1.3 Million - Policy reforms - Governance reforms |
| Pre-processing units/ Common Facility Centers 130-140 units Capacity: 11000sq.m./unit ~ 27-30 clusters Capital Cost: \$17Million <div> <div>IRR (15 yrs) 16%</div> </div> | | |
| Production units 30-40 units 5-6 CFC catering per unit | | |