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The AIIB's Concept for Development and Financing: Putting Global Value Chains to the Fore[1]

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What is the difference between the Asian Infrastructure Investment Bank (AIIB) and other currently existing development and financing institutions? In this author's view, the basic difference lies in their concepts and positioning.

One view holds that, different from the World Bank and the Asian Development Bank (ADB), which are committed to poverty-reduction, the AIIB prioritizes infrastructure investment and giving support to economic and social development in Asian countries. Yet, as a matter of fact, all multilateral institutions for development and financing, in particular those institutions targeted at aiding developing countries, provide pivotal services for infrastructure construction. For instance, the ADB focuses 60 percent of its loans on infrastructure such as transportation, and communication, energy and water conservancy facilities. And the proportion of loans extended for infrastructure by the World Bank accounts for almost 50 percent. This view holds that if we take into the consideration the abundant capital owned by these financial institutions, then, the AIIB is not special anymore as its functions or positioning are concerned.

But, as can be seen from articles in foreign media with titles such as "China's plan to export pollution," the establishment of the AIIB and the launching of

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the Belt and Road Initiative have aroused concerns in the world that China is exporting backward production capacity and environmental pollution.

Meanwhile, Japan is also working to promote infrastructure investment. Japanese Prime Minister Shinzou Abe announced in late May of 2015 an investment program of $110 billion for infrastructure construction in Asia, stressing "high-quality infrastructure."

So what development concept should the AIIB and the Belt and Road Initiative adopt to address such concerns?

This is an issue related to the positioning of the AIIB.

In fact, the issue of quality is not an issue confined specifically to infrastructure, but rather a basic issue for all commodities. The unique features of investment in infrastructure are networking, externality and infrastructures' fundamental position in the global value chain. Taking these into account, what concept for development and financing should the newly emerged multilateral institution adopt?

Let's take ginger production in Nepal as an example. In 2013 ginger produced in Nepal accounted for 12 percent of the world's total production, the third highest proportion after India and China. At the same time, Nepal's exports of ginger also rank third in the world.

However, ginger in Nepal cannot sell for a good price. According to statistics from the United Nations Food and Agriculture Organization, the price for ginger exported by China is $833 per ton, by India $1,173 per ton, and by the Netherlands $1,407 per ton. The ginger exported by Nepal is priced at just $195 per ton. The Nepalese ginger price is 23 percent that of China, and 14 percent that of the Netherlands. Nepal actually cannot gain any benefits from such a low ginger price.

What Is the Reason?

The main reason for this is the relatively low quality of its ginger. In many of Nepal's ginger producing areas, ginger breeds that are high in fiber with a rough texture have not been improved. At harvest time, peasants just pick up a big bag at home, fill it with dozens of pounds of ginger, and sell them in markets miles away. With no automatic facilities for washing and sorting, most of the ginger from Nepal is exported abroad without processing.

A second reason is a lack of high value-added downstream industries. In China there is a saying "to have radish in winter and ginger in summer." Ginger has high added-value and multi-purpose uses. For instance, ginger has medical properties and is used to inhibit tumors and treat migraines. Ginger is also used to alleviate travel sickness, sobering up, and for treating acne. In addition, ginger is made into ginger sugar and ginger-flavored candies. All these deeply processed products have high added value with high value per unit weight, and such products for export are economical in the face of high transportation costs.

However, such processing industries do not exist in Nepal, not only because of difficulties in merging the industry with the demands of the market, but also because of the backward infrastructure in Nepal.

The poor infrastructure in Nepal negatively influences the transportation and trade of it is ginger. According to the World Bank's development indicators, in 2012, the road length per 100 square kilometers in India was 2,226 km, while the equivalent road length in Nepal was only 121 km, accounting for one-tenth of that in India, which itself is considered to lag behind in infrastructure development. Half of the roads in Nepal are not asphalted roads. In addition, there are almost no railways in Nepal to speak of. Closely related to infrastructure, Nepal has a severe energy shortage problem. Nepal has to import a large proportion of its energy, and its electrification is only 60 percent that of India.

The severe infrastructure needs in water conservancy, energy and transportation means high value-added downstream industries do not exist in Nepal. The Word Economic Forum in Davos said in its report on international competitiveness that, among 148 world economies, the infrastructure in Nepal ranks 132, with a standard score of 2.1 (out of a possible top score of 7). Even India, with its poor infrastructure, has a standard score of 3.6.

The electricity rate in Nepal shows the deficiency of Nepal's infrastructure. In South Asian countries, Nepal has the highest power bill, 18 percent higher than that in Sri Lanka, 43 percent higher than in Pakistan, and 115 percent higher than in India and Bangladesh.

The backward development in infrastructure has not only bottlenecked the processing of ginger in Nepal, but also made it difficult for Nepal to modernize its ginger planting, irrigation, storage and transportation, resulting in a decline in quality and the efficiency of production. For instance, to export a shipment of goods, generally speaking, it takes about one and a half months for Nepal, one month for other South Asian countries such as India, and half a month for ASEAN countries.

In addition to the above mentioned reasons, another reason, which is a more vital one, is that most of the ginger produced in Nepal can only be sold to India. Sandwiched between China and India, Nepal is a landlocked country with the Himalaya in the north, its only unblocked logistics are with India in the south.

Therefore, Nepal relies heavily on India for its exports, and 60 percent of its ginger is sold to India. If the transit trade is taken into account, then almost all the ginger produced in Nepal has to go via India. The price of its ginger is thus vulnerable to being forced down since there are no other competitive channels for its exports.

This factor tends to be exploited sometimes. In 1989, India imposed a trade embargo on Nepal. Although the two countries have normalized trade relations, the possibility of a future embargo presents potential uncertainties for Nepal in its foreign trade. Even in normal times, Nepal has to cope with many problems in its transit trade via India. For instance, three Indian states that share a border with Nepal have reached understandings on minimum rates on freight from Nepal; the Indian authorities have a monopoly over the insurance business on some export products from Nepal on the grounds of their sensitivity; and dilatory actions from India lead to frequent delay of goods since Nepalese businessmen have to sell goods to a third country via India and have to go through customs twice.

How Could Nepal Integrate with the Global Value Chains?

Under the current circumstances, the trade relations between Nepal and its most important trading partner India mainly feature Nepal's primary product exports and end product imports. Such a trade structure means that Nepal is very much marginalized in the global value chains.

But if investment were put only into high value-added downstream ginger products such as medicines, cosmetics and confectionary, then insufficient water conservancy, power and transportation infrastructure would cause feasibility problems. However, direct investment in infrastructure might also be a problem. Infrastructure, with its positive externalities, would benefit high value-added downstream sectors and products, yet where are the benefits for the investors in infrastructure projects? Investments in infrastructure require large amounts of money with a long period before there are any returns. Therefore, investment in infrastructure and investment in other high value-added downstream products are inseparable and should be considered together.

Yet even if Nepal improves its infrastructure and its domestic value chains for ginger are extended, it will still be difficult for its ginger exports to have a smooth access to the global value chains because of its geographical situation.

Therefore, investment cooperation with Nepal should pay attention to the following: on the one hand, the focus should be on extending the domestic production chains. Through the overall planning of investment in infrastructure and high value-added downstream industries, Nepal's domestic ginger production value chains could be extended, thus bringing more benefits with regards jobs, tariffs and other spillover effects. On the other hand, attention should be paid to the connections with the global value chains. By promoting transportation and infrastructure construction that links Nepal with China and the rest of the world, ginger production chains in Nepal could be aligned with the global value chains.

The case of Nepal is somewhat common in the region. For example, Indonesia's marine fisheries are also confronted with short domestic value chains and low added-value for its marine products. Therefore, the value chains of Indonesia's marine products and aligning the industry with the global value chains are feasible areas for investment.

It should be pointed out that although the AIIB will not be directly involved in high value-added downstream industries, downstream industries should constitute part of the overall value chains investment planning. The AIIB has prioritized investment in infrastructure. However, the development of country's infrastructure should not be divorced from the development of its high value-added downstream industries, nor ignore the international production chains and global value chains. Without high value-added downstream industries, the AIIB's investments in infrastructure will be of no avail, and repayments from a project will become a problem. Without any overall planning and policy guidance at an early stage, the construction of a whole value chain will take longer, and the period before investment returns are achieved will be greater. Therefore, at the time when the global value chains are becoming increasingly integrated, world multilateral financing institutions such as the AIIB should break away from the old practice of focusing on individual projects and move towards investment packages that focus on integrating upstream and downstream industries.