



Asia-Pacific
Economic Cooperation

Advancing Free Trade
for Asia-Pacific Prosperity

Research Outcomes

Summary of
Research Projects 2013



Policy Support Unit

Asia-Pacific Economic Cooperation (APEC)

was established in 1989. The 21 Member Economies are Australia; Brunei Darussalam; Canada; Chile; China; Hong Kong, China; Indonesia; Japan; Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; Philippines; Russia; Singapore; Chinese Taipei; Thailand; United States; and Viet Nam.

APEC Policy Support Unit (PSU)

was established in 2008 as the policy research and analysis arm for APEC. It supports APEC members and fora in improving the quality of their deliberations and decisions and promoting policies that support the achievement of APEC's goals by providing objective and high quality research, analytical capacity and policy support capability.

Research Outcomes

is an annual publication of the PSU which provides a summary of research projects that the PSU has undertaken in a year. It is now in its third run. For previous years' publications, please visit www.apec.org/About-Us/Policy-Support-Unit/ . If you have any feedback or comments, please write to us at psugroup@apec.org.





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Trade & Investment Liberalization & Facilitation

APEC's Bogor Goals Dashboard

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Full Report: 34 pages

The purpose of the Bogor Goals Dashboard is to provide easy-to-understand figures to track the advances in areas critical to promoting greater regional economic integration, such as liberalization and facilitation of trade and investment. The intention is to display a set of harmonized indicators laying out the evolution across time of certain aspects of trade and investment liberalization and facilitation in quantitative terms.

This report provides updated figures on the indicators included in the APEC's Bogor Goals Dashboard, which was presented to APEC Senior Officials in 2012. The list of indicators included in the Dashboard consists of:

Goods Trade

1. MFN Applied Tariff (HS 6-digit level simple average)
2. MFN Applied Tariff - Agriculture (HS 6-digit level simple average)
3. MFN Applied Tariff - Non-Agriculture (HS 6-digit level simple average)
4. Zero - Tariff Product Lines (%)
5. Zero - Tariff Imports (%)
6. Percentage of Product Lines with MFN Tariff Rates \geq 10%
7. Non-Ad Valorem Product Lines (%)
8. Non-Ad Valorem Imports (%)
9. Logistics Performance Index - Overall Index (1 = low, 5 = high)
10. Lead Time to Export (days)
11. Lead Time to Import (days)
12. Cost to Export (USD per container)
13. Cost to Import (USD per container)
14. Documents to Export (number)
15. Documents to Import (number)

Services

16. Services Sectors with GATS Commitments
17. "Best" RTA/FTA Services Commitments Achieved (0 = no commitments, 100 = full commitments in all sectors)
18. Number of RTA/FTAs with Sectoral Services Commitments - Number of RTA/FTAs

Investment

19. Prevalence of Foreign Ownership (1 = very rare, 7 = highest)
20. Business Rules Impact on FDI (1 = very rare, 7 = highest)

Please refer to the full report for the APEC Dashboard and those for each APEC member economy. For more comprehensive details, readers are advised to read the Dashboard's technical notes.

Findings

The Dashboard indicates that the APEC region has made good progress in terms of trade liberalization. For example, during the period 2008-2011, average tariffs went down from 6.6% to 5.7%, and the percentage of zero-tariff product lines went up from 42.4% to 45.3%. However, in terms of trade facilitation, while it has become easier and faster to export and import nowadays, it is also becoming more expensive.

In services, there are a greater number of preferential trade agreements with sectoral services commitments. There is also some evidence of an increase in the depth of services commitments in preferential trade agreements.

With respect to the investment indicators, there has been a slight decline in experts' perception of the prevalence of foreign ownership in companies and the impact of business rules on FDI in the APEC region.

Expanding the Information Technology Agreement

Series: Policy Brief No. 6
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Published Date: May 2013
Full Report: 7 pages

The Information Technology (IT) sector revolutionized the global economy beginning in the 1990s, facilitating access to information and streamlining our daily activities. Globalization has deepened even more in the years that followed as IT improved connectivity within and across borders and created new services that boosted economic efficiency.

To better promote the IT sector and make these new technologies more widely available to the public, the WTO Information Technology Agreement (ITA) was negotiated in the mid-1990s. Despite its success in reducing trade barriers, the ITA has not kept pace with the rapid development in the IT sector. Since the ITA was signed 16 years ago, some products have become obsolete and new products appeared in the market. To better reflect the current development in the IT sector, a number of ITA signatories have shown increasing interest in expanding the ITA's coverage.

This policy brief argues for an expanded ITA and shows how APEC can play a leading role in that process. It reviews how the ITA was achieved, elaborates on APEC's role in bringing the agreement into existence, and demonstrates why APEC members should take the lead in WTO discussions towards a successful ITA expansion.

Findings

Declining growth rates of ITA products' trade flows

- The rate of expansion of ITA products' trade has dwindled in recent years. This has led to a decline in ITA products' share of total world trade. In 2003-2004, ITA products explained for 13.2% of world trade; in 2010-2011, that share had fallen to 9.9%. For APEC economies, exports of ITA products fell from 21.8% to 16.4% of total trade and imports went down from 17.5% to 15.5%.

Obsolescence of ITA products

- Rapid innovation and the ever-quickenning technological cycle have significantly reduced the use of some products, causing global demand to plummet in recent years. For example, word-processing machines (HS 846911); accounting machines (HS 847040); teleprinters (HS 851722); telephonic and telegraphic switching apparatuses (HS 851730); and magnetic tapes (HS 852311, 852312, 852313 and 852440), among others are rarely produced and traded nowadays. These subheadings accounted for less than USD 200,000 in the period 2010-2011.
- Other products are still being produced and traded but their trade flows have fallen sharply over time. This list includes products such as electronic calculators (HS 847010 and 847021); facsimile machines (HS 851721); and telephone answering machines (HS 852020). The world trade of the hybrid integrated circuit (HS 854240) declined from an average of USD 17.1 billion in 2003-2004 to only USD 2 million in 2010-2011.

Important goods and services are currently out of ITA

- Many new products that currently account for a sizeable amount of world trade – commonly used items such as DVDs, VCDs, MP3 and MP4 players – have appeared after the ITA came into force and are not part of the agreement. Other products that are not part of the agreement include the Global Positioning System (GPS); consumer electronic products such as TV monitors and CD players; multifunctional devices that print, scan and copy; and scientific, medical and analytical instruments with IT applications.
- The current expansion discussions should also take into account the increasing importance of services trade in the IT sector. Many cross-border service transactions require the application of IT such as providing professional advisory services through videoconference. The medium of transactions is increasingly changing from goods to services, for example buying and downloading software online rather than buying it off-the-shelf in computer stores.

Growing interdependence of global production chains for IT products

- IT manufacturing is a prime example of a global production chain where parts, components, and accessories are sourced from many different places and the final assembly accounts for only a fraction of the total value-added, allowing firms to improve efficiency and keep costs low. A joint effort by the OECD and WTO analyzed the iPhone, which is assembled in China using components from around the world. Some of the components are currently not covered by the ITA and including them in a future expansion would facilitate higher levels of trade and international economic integration.

Encouraging others to join ITA

- The expansion of the ITA should not only focus on product coverage, but also on non-ITA participants joining the agreement. Within APEC, four member economies are not parties to the agreement (Brunei Darussalam; Chile; Mexico; and Papua New Guinea) and another (Russia) is working on its ITA schedule of commitments after becoming a WTO member. Other important markets that are not part of the ITA are located in South America and Africa, and these include Argentina, Brazil and South Africa, among others. Increasing ITA membership will allow covered products to have duty-free access to a much larger market.

Recommendations

APEC accounts for nearly 80% of the world trade of ITA products, demonstrating the importance of the IT sector to member economies and for APEC to take a leading role in the current WTO talks to expand the ITA. In 1996, APEC was instrumental in the negotiations that gave birth to the ITA. This time, APEC can play the same role to expand the coverage of both products and member participants and also, to make the ITA more relevant now and in the future.

A successful conclusion of an expanded ITA is in line with APEC's commitment to strengthen the multilateral system. It also takes on an increased significance as the Doha Round of negotiations have failed to make progress in recent years. APEC could become the catalyst to reach an agreement on the ITA expansion.

Rapid technological changes, obsolescence of IT products, and growing IT interdependence of global production chains are compelling reasons for the need to expand the ITA. Economic activities are also becoming increasingly more dependent on IT than ever before, both in the goods and services sectors. A modern and flexible ITA should consider these trends and include both goods and services in its final version.

Better market access for IT products and services is critical to foster innovation, spur productivity and boost economic growth. APEC's support at the highest level for an expanded ITA represents a unique opportunity for its members to demonstrate APEC's value by bringing a common understanding to ITA expansion talks, showing its capacity to build consensus, and achieve positive outcomes at the multilateral level.



Structural Reform

APEC's Ease of Doing Business: Interim Assessment 2009-2012

Publication Number: APEC#213-SE-01.13

Published Date: July 2013

Full Report: 50 pages

APEC Leaders in 2009 endorsed an APEC-wide improvement of 25% by 2015 in five key areas of doing business: (1) Starting a Business; (2) Dealing with Permits; (3) Getting Credit; (4) Trading Across Borders; and (5) Enforcing Contracts, with an interim target of 5% improvement by 2011, and a gradual target increase in 5 percent points every year from 2012 to 2015. This initiative is called the APEC's Ease of Doing Business (EoDB). This report seeks to establish if APEC collectively has met the interim pro rata target of 10% improvement by 2012.

Findings

Using the new set of indicators from the World Bank's Doing Business database, this new interim assessment confirms that APEC has continued to make collective progress in the EoDB initiative from 2009 to 2012. APEC's combined improvement across the five EoDB priority areas between 2009 and 2012 was equal to 11.5%, exceeding the 2012 pro rata benchmark of 10% improvement.

APEC: Accumulated Overall Progress of Ease of Doing Business Initiative (Average Values)

Improvement	Starting a Business	Dealing with Construction Permits	Getting Credit	Trading Across Borders	Enforcing Contracts	Overall Progress	Benchmark
2009 – 2010*	7.5	-0.8	5.6	1.8	0.0	2.8	2.5%
2009 – 2011 [◇]	18.3	10.3	8.8	3.1	0.7	8.2	5%
2009 – 2012 [†]	23.4	15.8	16.1	2.3	0.1	11.5	10%

Source: PSU calculations using data from World Bank, Doing Business 2011, 2012 and 2013 and updates to Doing Business database.

Note: Improvements are shown with positive values.

* The figures were taken from the APEC's Ease of Doing Business Interim Assessment published in October 2011.

◇ The figures were taken from the APEC Economic Policy Report published in October 2012.

† The figures were computed from the Doing Business 2013 dataset



The priority areas of 'Starting a Business', 'Dealing with Construction Permits' and 'Getting Credit' registered the strongest accumulated improvement, well above the pro rata benchmark of 10% improvement. The improvement in 'Starting a Business' was particularly strong, with remarkable progress across the whole APEC region. In contrast, APEC's performances in 'Trading Across Borders' and 'Enforcing Contracts' were below the pro rata benchmark, and even fell back in 2012 in comparison to 2011.

APEC's collective progress is still uneven across its members. The inclusion of median values provided a more accurate look at APEC's progress. For the period 2009-2012, the combined improvement of APEC's median values in all priority areas was equal to 8%, below the 10% pro rata benchmark. Only two areas showed an improvement above this benchmark: 'Starting a Business' with a median value of 23%; and 'Getting Credit' with a median value of 11.2%.

APEC: Accumulated Overall Progress of Ease of Doing Business Initiative (Median Values)

Improvement	Starting a Business	Dealing with Construction Permits	Getting Credit	Trading Across Borders	Enforcing Contracts	Overall Progress	Benchmark
2009 – 2011 [∅]	24.7	-1.0	0.9	5.0	0.0	5.9	5%
2009 – 2012 [†]	23.0	1.2	11.2	5.0	-0.3	8.0	10%

Source: PSU calculations using data from World Bank, Doing Business 2011, 2012 and 2013 and updates to Doing Business database.

Note: Improvements are shown with positive values

[∅] The figures were taken from the APEC Economic Policy Report published in October 2012.

[†] The figures were computed from the Doing Business 2013 dataset.

The comparison between changes in the average and median values indicates that the most striking differences appear in the area of 'Dealing with Construction Permits', where averages improved significantly, but the median values barely changed. A closer look at the data indicates that most of APEC's average progress in this priority area during the period 2009-2012 was largely explained by improvements in some economies that did not perform well and were located in the bottom half during the baseline year (2009).

Recommendations

Despite the collective progress achieved so far, there is room for improvement across the APEC region in all EoDB priority areas. The collective improvement rate of 11.5% achieved in 2012 is good, but as the APEC's median values have indicated, progress needs to be stronger and more uniform across its members. In addition, there are some areas where APEC can improve on, taking into account performances by other regions as a reference. For example, the average number of procedures to obtain a construction permit in APEC was close to 17; whereas for the rest of the world, it was around 15 procedures.

It will be important for APEC to intensify its efforts to meet the ambitious goal of a 25% improvement in EoDB by 2015. Capacity building activities and the implementation of reform programs must continue to benefit the APEC community and move collectively closer to the goal of making it 25% cheaper, faster and easier to do business in the APEC region.



Drivers of Regulatory Reform in Energy Efficiency and Renewable Energy

Series: Policy Brief No. 7

Publication Number: APEC#213-SE-01.14

Published Date: July 2013

Full Report: 4 pages

This policy brief is prepared based on findings from a PSU-commissioned study entitled 'Regulatory Reform – Case Studies on Green Investments'. It discusses the motivations behind regulatory reforms in the energy sector and the factors that should be taken into account when designing and implementing such reforms, drawing from APEC economies' experiences with implementing energy efficiency and renewable energy policies.

Findings

Motivations for regulatory reform in the energy sector

- Energy security and environmental sustainability are underlying factors motivating regulatory reforms in the energy efficiency and renewable energy sectors. Other factors such as the level of economic development also influence energy policymaking. The oil crises of the 1970s highlighted the energy security risks of over-reliance on imported oil. In the aftermath of the crisis, governments began implementing energy efficiency and conservation policies to reduce the overall energy consumption and diversify their energy sources.
- More recently, environmental concerns related to global climate change have given impetus to government efforts at promoting energy efficiency improvements and renewable energy technologies. Regional and local pollution and safety concerns (e.g., with nuclear energy) have played a role in shaping policies on energy efficiency and renewable energy as well.

- APEC economies have been among the pioneers in the introduction of regulations to promote energy efficiency and renewable energy. In order to diversify sources of power generation, governments are trying to promote the use of non-conventional sources, including renewables such as solar, wind, biofuels and geothermal sources. The need to use energy resources more efficiently has also been the focus of governmental efforts in promoting energy efficiency over the past two decades.

Challenges for regulatory reform in the energy sector

- Regulatory reform in the energy sector can be extremely difficult to implement when significant constituencies exist in support of existing inefficient policy regimes, for example those which carry subsidies.
- Governments in many developing countries face challenges in eliciting popular support for market-oriented energy sector reforms when political viability and durability is a higher order criterion than economic efficiency. Similar constraints of political feasibility also operate in many developed economies.

Design and implementation of regulatory reforms

The effectiveness of reforms has varied both across APEC economies and different sectors. Based on an analysis of the PSU-commissioned study on 'Regulatory Reform – Case Studies on Green Investments', the following factors are especially pertinent in determining the success of the regulatory reform process:

- Executive leadership and institutional coherence to conduct reforms: The implementation of energy sector reforms involves cross-cutting efforts across various ministerial and agency jurisdictions within government at local, provincial, and national levels. It is thus important to have a clear delineation of responsibilities among all entities involved in the reform process. Coordination at the political level among authorities to make high-level executive decisions when needed and steer the process in the right direction is also necessary.
- Stakeholder consultation and communication with constituencies: Within APEC, policymaking in general is becoming a more transparent process. In many developing economies of APEC, there is increasing pressure to establish transparent and equitable processes when introducing new regulations or reforming existing regulatory regimes. This increasing demand for transparency can be a positive motivating factor in government initiatives to obtain the buy-in from affected constituencies. Promoting awareness of the expected social and economic benefits of proposed

reforms and public-private partnerships are also important to the effective implementation of energy sector reforms.

- Avoidance of regulatory capture: Stakeholder engagement is very important as it brings legitimacy to any regulatory reform process. While there are obvious benefits from engaging stakeholders in policymaking, it is important to recognize the danger of stakeholders having too much influence on the policy outcome.
- Sequencing and timing of policies: Public education campaigns and mass media coverage can help in the roll-out of policies, where affected constituencies are informed of the sequence and timing of specific regulations.
- Continuity of reforms and policy revisions: Regulatory reform is a continuous process. Economic, political and social conditions are not static and policies require adjustments as conditions change. In many cases, governments have been flexible in reviewing policies to respond to changes in existing conditions. In certain cases, policies are updated by rule after a specific number of years.
- Using cost-benefit analysis in decision-making process: Cost-benefit analysis (CBA) has not been the norm in the case studies on energy efficiency and renewable energy presented in the PSU study. As a result, it is not entirely evident to policymakers as well as affected constituencies whether the proposed

regulations which are expected to yield the greatest net benefits to society are being selected during the policy formulation stage, or whether the existing policies are being adequately evaluated on an ex-post basis to see if their actual implementation pass the social cost-benefit test. Having a framework to conduct CBA could improve the regulatory reform decision-making process.

Recommendations

To improve the quality of the regulatory reform process in the fields of energy efficiency and renewable energy, APEC member economies could focus their efforts in the following three areas:

- Strengthen collaboration between the APEC Economic Committee and other working groups, and promote the development of metrics to properly assess regulatory policies.
- Emphasize on more widespread use of CBA as a tool in the decision-making process.
- Promote mechanisms to strengthen stakeholder consultation.



Connectivity including Supply Chain Connectivity & Global Supply Chains

The 2013 Interim Assessment for Supply Chain Connectivity Framework Action Plan

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Published Date: April 2013

Full Report: 106 pages

APEC has a very good track record in the area of trade facilitation. The two successive Trade Facilitation Action Plans (TFAPs) had succeeded in reducing trade transaction costs by 10% over the period 2002-2010. In 2010, the Committee on Trade and Investment (CTI) decided to build on this achievement by re-focusing the member economies' attention on the broader issue of supply chain performance through the Supply Chain Connectivity Framework Action Plan (SCFAP) and setting a target of a 10% improvement in supply chain performance in terms of time, costs, and uncertainty by 2015.

This project is an attempt to measure the interim progress of SCFAP implementation as well as provide feedback to further improve SCFAP implementation in order to achieve the 10% overall goal. Working closely with member economies, PSU constructed a measurement framework comprising a three-tracked assessment of internal indicators, external indicators and self-assessment survey, to find out the extent in which SCFAP actions are contributing to improving supply chain performance.

Findings

External indicators assessment

Several important points could be highlighted from the external indicators assessment.

- In terms of time, APEC economies have been quite successful in reducing trade times by nearly 7% (using Doing Business data on export time and Logistics Performance Index (LPI) data on import time). This progress would translate into significant cost savings for businesses, exporters, and consumers.
- In terms of cost, there is some indication of costs increase; however this could be a result of unexpected supply chain disruptions due to natural events such as earthquakes and floods. It remains to be seen whether this trend of costs increase will continue. Nevertheless, APEC economies should look into monitoring and reducing costs in the coming years.
- In terms of uncertainty, based on the percentage of shipments meeting firm quality criteria from LPI, there has been a positive increase by about 4% over the period 2009-2011. The percentage of shipments that are physically inspected also showed significant improvement and met the interim target. Collectively, this could be interpreted to mean a similar reduction in the level of supply chain uncertainty.

APEC has made significant progress in reducing the time and uncertainty of supply chain performance. Notwithstanding, it is important for member economies to make further progress in some areas, as indicated in the traffic light analysis that was conducted for this project.

Internal indicators assessment

The internal indicators assessment shows that 77% of actions were completed within three years of SCFAP implementation (2010 to 2012), reflecting good progress in terms of project completion and implementation. It also shows there is room for improvement such as for member economies to add more actions into SCFAP and to continue with the ongoing actions included in SCFAP until 2015 in order to move towards the 10% overall goal.

Self-assessment survey results

The self-assessment survey results show that member economies have experienced benefits from SCFAP-related projects in improving supply chain performance, such as:

- Knowledge sharing or measures in addressing the knowledge gap. This is the most notable benefit as the SCFAP actions have helped to raise awareness on important issues related to supply chain performance, and provided a reference or policy guidance to member economy/sub-fora for further improvement.
- A platform or network for economies to communicate with the industries, and to actively engage and enhance the capacity of SMEs. The actions under SCFAP have helped to improve the relationship between the government and the private sector, including SMEs.
- Improve awareness and understanding of new technologies that are important to the logistics and transportation sectors.

Recommendations

This report provides the following recommendations to member economies:

- Re-double their efforts in reducing the time, costs, and uncertainty in supply chain performance.
- Target efforts at maintaining the existing key long-term measures that have been initiated and expanding them by leveraging on ICT development.
- Maintain an open and transparent channel or communication with relevant stakeholders in the private sector in order to improve the regulatory environment.
- Encourage the design of appropriate capacity building initiatives to address the existing knowledge gap in a systematic and sustainable manner.
- Provide further support to SMEs to ensure mutual collaboration between industry players, large and small, within the logistics and transportation sectors.
- Act on the feedback provided in the self-assessment surveys by improving SCFAP design and implementation.
- Undertake a further assessment of SCFAP progress in 2014 by using updated figures from the external indicators.

Global Supply Chain Operation in the APEC Region: Case Study of the Electrical and Electronics Industry

Publication Number: APEC#213-SE-01.12

Published Date: July 2013

Full Report: 98 pages

This study aims to provide a detailed understanding of the current electrical and electronics (E&E) industry supply chain operations, strategies and challenges, and suggest approaches APEC might adopt to make these supply chains and others more efficient and better contribute to economic integration in the region.



Findings

Among the primary findings are:

- Final assembly of consumer electronics has become increasingly centered on Asia, particularly China since 2001. At the same time, it is important to note that China's high electronics export volumes contain a large percentage of products that are merely assembled locally, using parts that are manufactured in other APEC economies such as Chinese Taipei, Korea, Japan, and Malaysia. Additionally, the rising cost of labor in China has begun to cause some of these assembly operations to shift to lower cost economies such as Viet Nam.
- In the case of the relatively younger and more robust smartphone industry, there tends to be a higher degree of vertical integration and vendor micromanagement in supply chain operations, making it more challenging for new suppliers to join. The more mature and price-sensitive laptop and LCD TV industries tend to have more decentralized supply chains with heavy use of contract manufacturers.

- The key factors impacting the selection and location of suppliers are: (1) strong technical workforce skills; (2) ease of labor mobility; (3) access to financing; (4) incentives for foreign direct investment; (5) low labor costs; (6) high scalability; (7) well-regulated working conditions; (8) advanced infrastructure; and (9) proximity to end markets, which all contribute to the potential for development of domestic and regional supply chain operations. Challenges that may reduce the competitiveness of certain suppliers or regions include short product life cycles, natural disasters, and trade barriers.
 - In terms of benefits from supply chain participation, economies may realize direct economic benefits in the form of increased employment and tax revenue, as well as tangential benefits such as technology transfer to other sectors of the economy. In an optimal situation, a sizable cluster of supply chain production operations will attract a variety of supporting businesses to provide services, multiplying benefits to the community. At the same time, governments need to ensure that regulatory measures keep pace with the demands of supply chains upon the local economy, lest there be any collateral damage such as increased occupational health risks for factory workers.
 - Depending on each government's focus on policy planning, current policy initiatives range from China's highly targeted and heavily funded next generation information technology / electronics development plan, to the U.S. government's very modest investments in support of general manufacturing activities. Policy priorities vary somewhat according to the evolutionary stage of the electronics supply chains in each economy. Workforce skill upgrading stands above all as the most common policy priority, and is likely to remain so as rapid technology changes constitute a relentlessly moving target for economies at all levels of development.
- As for the trends in future supply chains, some key points are:
- China can be expected to remain as the core hub for global electronics supply chains in the foreseeable future despite recent wage increases in urban areas of 20% or more. At the same time, for vendors that currently outsource mainly to contract manufacturers in China, other low cost economies such as Viet Nam; Thailand; Malaysia; and Indonesia may become more attractive as production locations, presuming that the local infrastructure is sufficiently developed and enough skilled manpower is available.
 - Vendors are likely to continue outsourcing non-core operations while at the same increasing vertical integration of core competencies.
 - While reliability and Quality of Service are top concerns for vendors concerning supplier performance, the risk of non-adherence to delivery schedules and the risk of non-compliance to environmental regulations are challenges that vendors would face as they increase their reliance on outsourcing.
 - Across the electronics industry, the time to respond to market demands and changes is shrinking. Vendors need to be agile and flexible, ready to expand and grow their supply and production networks in an environment that does not allow accurate forecasting.
 - There is a clear need for the creation of a supply chain risk management strategy, allowing vendors to respond to increasing numbers of natural disasters such as earthquakes, tsunamis, floods, and hurricanes which are potential threats that have caused major disruptions to key electronics supply chains in the past. Accidents such as fire or major electrical power outages in factories can also have adverse effects on supply chains. To mitigate such risks, vendors might have to outsource critical parts from multiple suppliers, across multiple factories in multiple economies.

Recommendations

To grow the E&E supply chain efficiency and economic success, among the key policy recommendations for economies are:

Build up human capital

- Developing human resources and providing technical and managerial training and flexible immigration policies to foster the growth of a large and capable workforce.
- Maintaining and improving good working conditions for workers.
- Promoting the legal mobility of high skilled workers and researchers to help economies build the scale of their electronics industry and increase the potential to develop high-value patents.

Assist and facilitate business

- Exploring possibilities to develop further along or down the supply chain as appropriate.
- Improving access to financing and education on overseas regulatory environments to help SMEs to expand abroad, particularly for low-margin products.
- Creating the necessary climate to develop high tech 'clusters' to build innovation and technology development.

Strengthen regional integration

- Continuing to promote free trade agreements and reduce tariffs.

Build up physical and ICT capabilities

- Developing infrastructure such as transportation and telecommunications networks.

Improving Connectivity in the Asia Pacific Region: Perspectives of the APEC Policy Support Unit

Publication Number: APEC#213-SE-01.19

Published Date: October 2013

Full Report: 86 pages

Connectivity has become an important issue for many international organizations in recent years. This study provides examples of concrete efforts and progress made within the Asia Pacific region by these organizations in three key areas of connectivity - institutional, physical, and people-to-people - as well as highlight key issues and challenges in each of these areas. The study also highlights the current state of connectivity in the APEC region as well as the possible way forward.



Findings & Recommendations

Findings from the mapping exercise conducted for this study reveals that each international organization designs their initiatives based on how to best reach their own underlying objective. ASEAN designs their connectivity initiatives in order to realize the ASEAN Community. The World Bank is pursuing their transport and trade facilitation agendas in order to support their development objectives, and ADB has worked extensively in supporting infrastructure and institutional connectivity to enhance regional physical infrastructure as well as in developing regional corridors.

APEC would need to view the APEC Framework on Connectivity based on APEC's existing pillars of trade and investment liberalization; business facilitation; and economic and technical cooperation. The existing work on trade facilitation should also be taken into consideration. Viewing the three areas of connectivity within a holistic framework instead of viewing them in silos is crucial. Improved institutional connectivity, such as better customs cooperation, will strengthen transport linkages. Improvement in physical connectivity, for example in better air transport infrastructure, will facilitate the movement of business people and scholars and further strengthen the efforts on people-to-people connectivity. Exploring future trends and scenarios of the global trade architecture is also crucial.

Moving forward, the framework should be seen as a starting point of a coordinating mechanism to streamline, synchronize, and harmonize related APEC initiatives that have been and currently are being implemented by the committees and working groups. The framework could act as guiding and strategic principles for APEC's future work on connectivity. Further efforts to operationalize this framework would also be necessary so that it could function effectively by involving related APEC fora and the business community.

The study offers the following key conclusions:

Institutional connectivity

- APEC has made progress in trade facilitation and many behind-the-border issues. While the Single Window development is progressing well, it needs more high-level political support and coordination among trade-related government agencies in addition to harmonized systems and procedures/regulations. Enforcing contracts through the courts has remained a challenge as it involves changing long-time habits and procedures. For FTAs and RTAs, low utilization rates, limited capacity for SMEs to access and process information, and complicated and divergent ROO mechanisms should be addressed.
- Harmonization and mutual recognition of standards leading to interoperability, both within domestic agencies and across different economies, are crucial to further bring down the costs of trade. Additionally, facilitation in logistics and transport regulations will also help reduce trade costs.

- Efforts to encourage cross-border investment flows should be further pursued as they support physical connectivity.
- Expanding trade routes and corridors would be another important future initiative. Emphasis should be on developing trade corridors that could provide more viable options for business in moving their goods using alternative modes of transport.

Physical connectivity

- Meeting the higher levels of demand for infrastructure services will require considerable investment from both the public and private sectors. Public-private partnership (PPP) is one strategy to overcome this gap, though there are limitations in the development and implementation of PPP projects. Creating a more enabling investment environment is another effort which can improve physical connectivity.
- In order to accelerate the region's progress towards achieving greater physical connectivity, a multi-year action plan that addresses the bottleneck of infrastructure deficits is required. Greater ground transport investments, such as in the railroad network, would be strategic in improving the region's overall competitiveness. Improving on the competence and quality of maritime transport services would also bring high returns.

People-to-people connectivity

- Skilled labor finds a natural home in APEC's work on services trade, an important and growing sector within the APEC region. As global trade and global value chains thrive, the need for more global entrepreneurs and skill shortages could occur in certain economies. Supporting the 'global mobility of talents' would help to address this issue. Mutual Recognition Arrangements (MRAs) in professional services and better cooperation in visa arrangements would facilitate skilled labor mobility. Business travel facilitation arrangements such as the APEC Business Travel Card (ABTC) scheme could develop new business opportunities and strengthen cross-border investments which provide an enabling environment for nurturing global entrepreneurship within the region.
- There is still substantial room to expand the tourism sector and harness an important area of potential growth, such as strengthening the connection between tourism and air transportation since majority of international tourists depend on air transport.
- In order to expand APEC's work on cross-border education, focusing on the APEC Education Network, a part of the APEC Human Resources Development Working Group's efforts towards people-to-people connectivity and cross-border education, could offer a good opportunity for progress and implementation.

Economic & Financial Analysis

APEC Economic Trends Analysis

The APEC Economic Trends Analysis provides an overview on emerging trends underlying the region's economic prospects by providing in-depth analysis on recent macroeconomic and financial developments in the APEC region. The report is prepared prior to the APEC Economic Committee (EC) meeting to serve as a source of information for discussion among EC members as well as other APEC officials.

Series: April 2013 - Navigating towards Sustainable Growth in a Changing Landscape

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Findings & Recommendations

The recovery of the global economy in 2012 faced disruption for a second consecutive year. Global trade was negatively impacted.

- The global economy experienced a turbulent 2012 as concerns over the health of the Euro area's sovereign debt and the financial sector weighed down business and consumer sentiment. In the second half of 2012, the Central Banks of large advanced economies, including the U.S. Federal Reserve, the Bank of Japan, the Bank of England, and the European Central Bank (ECB), moved aggressively to help stabilize financial markets by keeping interest rates low and expanding the use of non-conventional zero-lower bound policies such as quantitative easing.
- While efforts by these Central Banks helped to reduce market uncertainty and improve investor sentiment, the recovery of the global economy faced disruption for the second consecutive year. Global GDP growth moderated from 3.9% in 2011 to an estimated 3.2% in 2012, two-thirds of the 5.1% growth registered in 2010.
- Amid the deteriorating external environment, GDP for the APEC region as a whole grew by 4.1% in 2012, the same growth rate as in 2011.

- Global trade was particularly weak. By October 2012, the value of global exports barely grew from the level seen in 2011. While reduced import demand from Europe played a relatively large role in decelerating trade flows, rising trade restrictive measures and a reduced availability of trade finance also negatively affected trade. Over the period between mid-October 2011 and mid-October 2012, 308 new restrictive trade measures were implemented, affecting around 1.3% of global imports. With respect to trade finance, the deleveraging by European banks resulted in a 35% drop in lending, compared to pre-crisis levels.
- Weakening trade was the Achilles' heel for small open APEC economies, including the Newly Industrialized Economies (NIEs) in Asia. GDP growth for these economies slowed sharply to 1.7% in 2012, less than half of the 2011 growth rate.
- An encouraging trend observed in many APEC economies in 2012 was the recovery of investment and a greater resilience in private demand. Low interest rates, increased volumes of international investment, and strong equity markets improved household wealth and have led to more spending. As a result of this strong domestic demand, many APEC economies managed to offset weakness in the external sector and post strong GDP growth.

Positive signs have emerged in the APEC region in the first quarter of 2013 and growth is expected to strengthen as the year progresses.

- According to the IMF, global GDP is expected to accelerate to 3.5% in 2013 and 4.1% in 2014, from an estimated 3.2% in 2012. APEC's GDP is forecast to grow by 4.2% and 4.7% in 2013 and 2014, respectively. Developing economies are expected to be the main engine of economic progress, contributing to more than 70% of global growth in the short to medium term.
- Recent developments have been consistent with the forecast of a soft recovery in 2013. Activity in some large APEC economies, Japan and the United States, is steadily improving. The strengthening housing market in the United States is a good sign of optimism.
- Robust activity in the United States and in some emerging APEC economies is contributing to a rebound in global trade. The volume of world imports increased by a strong 4.1% (y-o-y) in January 2013, marking the sharpest pick-up since September 2011. Import demand was strongest among emerging Asia, rising 7.6% (y-o-y). The recovery in world demand for traded goods has helped to support prices of these goods as well.

The high level of sovereign debt in some advanced economies, and the risks of asset price bubbles and large currency appreciations associated with large capital inflows, are posing challenges.

- At the heart of risks to the global economy is the high level of sovereign debt in some European economies that could spark renewed tensions in the global financial markets. Significant tensions could re-emerge if a member economy misses its fiscal reduction target due to slower growth. The Euro area region remains vulnerable to political uncertainty which could derail its commitment towards restoring its public finance.
- The surge in capital inflows, as a result of improved investor sentiment and large quantitative easing policies pursued by Central Banks in major developed economies, is posing a serious challenge to macroeconomic management and financial stability.
- In some APEC economies, speculative buying has been a key factor contributing to soaring property prices. As the demand for real estate is set to remain strong, aided by low interest rates and abundant capital, property prices may surge further, thus raising concerns about housing bubbles.

- Strong inflows of foreign capitals are putting pressure on exchange rates. The steady appreciation of currencies in some trade-intensive APEC economies is eroding export competitiveness. It is of concern that the attempt to regain competitiveness may result in a simultaneous currency intervention by monetary authorities. If that were to occur, it would create larger imbalances in the patterns of global trade and investment. It is important that APEC remains committed in refraining from competitive devaluation of currencies.



Fine-tuning the pace and the composition of fiscal adjustment packages; increased vigilance on capital flows; strengthening the financial markets and institutions; and enabling an environment to channel capital inflows towards productive infrastructure investment are essential to navigate the region towards more resilient growth.

- Given that recovery of the global economy will be tepid and vulnerable to setbacks, it is imperative that policymakers in APEC take proactive measures in order to secure sustainable growth.
- For some industrialized APEC economies which are implementing fiscal austerity measures, it is important that the pace and composition of fiscal savings is fine-tuned with the pace of economic recovery. Achieving this requires governments to transparently communicate the medium-term targets which should also be backed up with a credible plan to raise revenue and address expenditure pressure.
- Governments should also be vigilant in monitoring the flows of capital in order to minimize risks of asset price bubbles. In some emerging APEC economies, the lack of depth and liquidity of the local capital market makes it more susceptible to pressures from large capital flows. In order to minimize the risks associated with large capital inflows, APEC needs to make progress towards strengthening the local financial systems and institutions.

- APEC economies should also take advantage of low borrowing costs and accessible capital to finance productive investment. In particular, governments should channel the inflows of capital towards financing much needed infrastructure developments.
- The combination of subdued growth in the short term and high volatility is making long-term investment more appealing to investors who seek to diversify their portfolios by staging investments across longer time horizons. This pursuit of long term investments by investors creates a good platform for policymakers to engage in public-private partnership. Infrastructure investment, in particular, would benefit greatly.

Series: October 2013 – Cautious Steps towards Recovery

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Findings & Recommendations

- Between Q3 2012 and mid-May this year, cumulative expansionary monetary policies pursued by central banks in some large economies, supported strong flows of capital internationally. The equity and stock markets in many emerging and developing economies (EM&Ds) were buoyed by this capital inflow recovery.
- In mid-May, tensions in the financial markets increased, partially due to an announcement by the U.S. Federal Reserve (U.S. Fed) on its strategy to reverse the expansion of its balance sheet, on the backdrop of weaker than expected economic growth in some EM&Ds. Yields on U.S. Treasury bonds rose by 80 basis points between the end of May and the first week of September. The June inflows of portfolio to EM&D fell to half the amount seen in May.
- Government bond yields in some APEC economies also rose. It appeared that bond yields increased to a greater degree in economies with larger current deficits and rising inflation.

- During May and September this year, equity prices in APEC developing economies underperformed compared to those in APEC industrialized and newly industrialized economies (NIEs). Over the same period, the depreciation in currencies was larger among APEC commodity exporters.
- The much anticipated recovery of global trade did not occur in the first half of this year. APEC trade was growing at a progressively moderate rate with exports to Europe contracting sharply.
- There were signs of funding tightening in EM&Ds in Q2 2012. Investment growth was slowing in the first half of this year. In some APEC economies, this was due to the reduced rate of expansion in the mining sector.
- Against the difficult backdrop of rising financial tensions and slower trade, the IMF downgraded its forecasts for the global economy and for the APEC region. APEC GDP is expected to moderate from 4.1% in 2012 to 3.9% this year, before accelerating to 4.4% in 2014. Much of the downward revision in the forecasts is due to slower than expected economic activity in some APEC EM&Ds in the first half of this year.
- As a group, APEC GDP rose at 3.5% in Q2 2013, a touch higher than the 3.4% in Q1 2013. This suggests APEC economic activity is shifting gears, from growing at slower pace towards a recovery.
- The normalization of monetary policies in some large economies, however, has implications on the global economy going forward. The first channel of impact is the rise in international interest rates which may have an adverse impact on markets with large external debt burdens. Most APEC economies, however, have made good progress in reducing their stock of external debt. The ratio of external debt to GDP for APEC EM&Ds fell from 41% in 1986 to 15% in 2011. The second channel of impact is the transmission of rising international interest rates into higher domestic lending rates, which in turn can cause lower investment and decreased domestic consumption.
- There is a concern that rising interest rates may complicate the task of re-engineering the economy towards stronger domestic demand. In the face of subdued trade growth, moderate domestic demand may derail the economic recovery.
- APEC in particular can play a significant role by continuing to make progress on the broad agenda of ensuring macroeconomic and financial stability. Doing so will reduce uncertainty in the economic outlook and help to support consumer and business confidence. APEC should also continue to make progress on the agenda to make the investment climate more favorable to investors.
- APEC EM&Ds account for 82% of APEC's total population but this group's household spending accounts for only 30.5% of the total APEC consumer expenditure. Therefore, policies to encourage more consumer spending in EM&Ds are critical for the pursuit of sustainable and inclusive growth. Policies that improve social safety nets and other insurance mechanisms can also be effective in promoting consumption. In the longer term, it is more fiscally sustainable to spur consumer spending by ensuring a healthy labor market and strong income growth.



Key Trends and Developments relating to Trade and Investment Measures and their Impact on the APEC Region

This report is presented following the commitment made at the APEC Ministerial Meeting (AMM) in Singapore in November 2009 to continue to review recent economic measures undertaken by APEC economies.

Series: April 2013

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Full Report: 20 pages



Findings

Economic outlook

- The global economic recovery suffered a further setback in 2012, resulting in real global GDP growth to slow to an estimated 3.2% from 3.9% in 2011. GDP in the euro zone fell by 0.5% in 2012 as ongoing concerns over the health of the region's sovereign debt and the possibility of an economy exiting the euro zone weighed down business and consumer sentiment. Although real GDP in the APEC region grew by an estimated 4.1% in 2012, the same growth rate as in 2011, the deteriorating external environment caused growth momentum to differ markedly among the APEC members. Reduced demand for exports, particularly higher value added goods such as IT products, proved to be a significant drag on growth in 2012, especially for the newly industrialized Asian economies. In contrast, many APEC economies were able to post strong growth in 2012 through increasingly resilient domestic consumption and investment, offsetting the weakness in the external sectors.

- The APEC region is expected to continue outperforming the rest of the world, with GDP forecast to grow by 4.2% in 2013 and 4.7% in 2014, compared with world GDP growth of 3.5% and 4.1%. There are indeed positive signs of a sustained recovery among both the industrialized and developing APEC economies. Nevertheless, uncertainty over the global economic recovery poses

significant risks to growth in the region. In particular, the recession in Europe is expected to continue for at least the first half of 2013, while there also remains ongoing uncertainty over the political will to implement the reforms necessary to put the euro zone on a sustainable path to recovery. Within the APEC region, low interest rates and abundant liquidity have created a risk of asset price bubbles. In addition, the large appreciation of domestic currencies against major global currencies could further erode the competitiveness of the export sector in some APEC economies.

Merchandise trade and trade-related measures

- Trade performance in 2012 was greatly impacted by the slowdown in global economic activity as weakened import demand in developed economies, especially in Europe, resulted in a corresponding deceleration in exports, particularly from developing economies. The WTO reports that total world merchandise trade volumes grew by 2.0% in 2012, decelerating from a 5.2% growth rate in 2011. For the APEC region, the value of exports grew by just 2.6% in 2012 to USD 8.7 trillion, a sharp slowdown from a growth rate of 17.2% in the previous year. Meanwhile, the value of imports to the region increased by 3.6% in 2012 to USD 9.0 trillion, after growing by 19.6% in 2011, thus widening APEC's trade deficit with the rest of the world. However, intra-APEC

merchandise trade outperformed trade in the rest of the world, expanding by 3.9% in the year to November 2012 compared with a contraction of 1.8% in the rest of the world.

- In light of the setbacks to the global economy in 2012 and the uneven economic recovery, the WTO has once again revised downward its forecast for trade growth, predicting that it will grow by 3.3% in 2013. However, there are considerable downside risks to trade growth, with the sovereign debt crisis in the euro zone considered to be the most significant. Encouragingly, the WTO recently reported that there had been a slowdown in the imposition of new trade restrictions by G20 members between mid-May 2012 and mid-October 2012.
- During this period, G20 members implemented 71 new measures that can be considered as trade restricting or distorting, affecting around 0.3% of global imports. However, the accumulation of restrictive measures by G20 members that remain in place since the global financial crisis remains high, and is estimated to cover around 3.5% of global trade.

Foreign Direct Investment (FDI) and investment-related measures

- The FDI recovery was also setback in 2012 with UNCTAD estimating that global FDI inflows fell by 18% to USD 1.3 trillion as companies remain cautious towards both domestic and foreign investment given the uneven pace of the global economic recovery. Although substantially reduced inflows to the European Union (EU) were responsible for just over half of the global decline, the APEC region also experienced a sharp decrease as inflows in 2012 fell by 17% over the previous year to USD 650 billion. FDI inflows to the United States dropped by 35%, mainly due to a fall in cross-border mergers and acquisitions (M&A). China also witnessed a slight decrease in inflows of about 3% due to rising production costs and lower demand for exports.
- UNCTAD forecasts that FDI inflows will rise only slightly to USD 1.4 trillion and USD 1.6 trillion in 2013 and 2014, respectively, revising downward previous forecasts. Although there remains concern that governments may introduce policies that are unfavorable towards foreign investment or that discourage outward investment given the uncertainty surrounding the global economic recovery, investment measures recently implemented in selected APEC economies were generally favorable to FDI. APEC members are also very active in treaty-making, with 10 of the 13 international investment agreements (IIAs) signed over the past year involving an APEC member.

Despite the relatively strong economic performance of the APEC region, the ongoing uncertainty in the external environment is of serious concern. The slowdown of global trade and economic growth in 2012 and the uneven economic recovery, as well as the considerable downside risks that remain, present substantial challenges for the region. Collective action by the entire global community to resist protectionism is therefore required in order to ensure the promotion of trade and investment, thereby supporting economic growth. APEC Ministers, meeting in Vladivostok, Russia in September 2012, had reaffirmed the pledge made by Leaders in Honolulu, USA in November 2011 to refrain from raising new barriers to investment or to trade in goods and services through the end of 2015.



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Full Report: 20 pages

Findings

Economic outlook

- GDP growth momentum diverged between advanced and developing economies in the first half of this year. As economic activity gathered strength in advanced economies, it began to slow in many developing and emerging economies. As a grouping, growth in industrialized APEC economies accelerated to 1.6% (year-on-year) in the second quarter of 2013 after expanding by 1.1% in the previous quarter. Output growth in the newly industrialized APEC economies also rose to 2.6% (y-o-y) in the second quarter from 1.5% in the first quarter of 2013. In contrast, GDP growth in developing APEC economies moderated to 5.8% (y-o-y) in the second quarter of 2013, from growth of 6.1% in the first quarter of the year.
- Given the slower growth and weaker domestic demand in several major emerging economies, the IMF recently lowered its forecast for global growth. Global GDP growth in 2013 is now expected to increase at the same rate (3.1%) as in 2012 before accelerating to 3.8% in 2014. Economic activity in the APEC region remains favorable in comparison with GDP forecast

to grow by 3.9% in 2013 before accelerating to 4.4% in 2014. Although risks to the outlook for global growth have subsided, they still remain on the downside. These include a re-intensification of the Euro area crisis, the normalization of monetary policy in some major developed economies leading to tighter financial conditions, as well as geopolitical tensions in the Middle East driving oil prices higher.

Merchandise trade and trade-related measures

- Trade performance in the first half of 2013 was also weaker than expected, with total world merchandise trade volumes growing by just 1.8% (y-o-y). Although import demand from emerging economies grew by 5.9% in the first six months of the year, it wasn't enough to offset the weakened import demand in advanced economies, which contracted by 1.7%. In the APEC region, the value of total merchandise trade grew by just 2.1% in the first five months of 2013 over the same period last year, with exports rising by 2.2% and imports by 2.0%. Intra-APEC trade held relatively steady, growing by 4.4%, roughly the same pace as in 2012. However, import demand from the Euro area continues to be particularly weak. The value of APEC exports to the Euro area contracted by 4.9% in the year-to-May after declining by 3.8% last year. Following growth of 3.7% in 2012, exports from APEC to the rest of the world also moderated, increasing by 1.6% in the first few months of this year.

- Given the sluggish growth in import demand by developed economies, the WTO recently revised its trade forecast downward, predicting that global trade will grow by 2.5% in 2013 and by 4.5% in 2014. Despite the cut in its forecast, the WTO is optimistic that the conditions underlying increased trade are improving, including an easing of the European sovereign debt crisis, a fall in unemployment in the United States, and GDP growth in Japan. The WTO also reports that between mid-October 2012 and mid-May 2013, there were 52 trade-facilitating measures implemented globally, covering 0.5% of world merchandise imports. However, over that same period, there were also 86 newly initiated trade remedy investigations covering around 0.2% of global merchandise imports compared with the termination of 47 trade remedy measures covering around 0.1% of world imports. Meanwhile, the impact of non-tariff measures (NTMs) on trade continues to be of increasing concern.

Foreign Direct Investment (FDI) and investment-related measures

- The FDI recovery was derailed in 2012 with UNCTAD reporting that global FDI inflows fell by nearly 20% to USD 1.35 trillion as both economic and policy uncertainty made investors more cautious. Although over 60% of the global decline in 2012 can be attributed to substantially reduced inflows to the EU, the APEC region also experienced a sharp decline as inflows fell by 10% over the previous year to USD 697 billion. While FDI inflows to industrialized members fell by nearly 20% in 2012 to USD 275 billion, those to developing APEC members proved resilient, declining by just 4% to USD 423 billion.
- UNCTAD forecasts that global FDI flows will rise only slightly to USD 1.4 trillion in 2013 before significant gains are made in 2014 and 2015, with FDI reaching USD 1.6 trillion and USD 1.8 trillion, respectively, as macroeconomic conditions improve and investors regain confidence. However, significant downside risks to FDI remain, including ongoing volatility in financial markets as well as sluggish economic growth in advanced economies. Encouragingly, APEC members seem to be faring quite well in ensuring that their policies are favorable towards foreign investment as the measures recently implemented in selected APEC economies were generally favorable to FDI.

Despite the favorable economic performance forecast for the APEC region compared with the rest of the world in 2013 and 2014, significant downside risks still remain. The underwhelming performance of global trade in the first half of this year and the drop in FDI last year presents substantial challenges for sustainable economic growth in the region. APEC members are therefore encouraged to resist protectionism, thereby ensuring the promotion of trade and investment both within their economies as well as within the region. APEC Ministers, meeting in Vladivostok, Russia in September 2012, had reaffirmed the pledge made by Leaders in Honolulu, USA in November 2011 to refrain from raising new barriers to investment or to trade in goods and services through the end of 2015. The WTO has also highlighted the need to make progress in multilateral negotiations in order to deliver concrete results at its upcoming Bali Ministerial Conference this December.



Trends in Trade Finance across the APEC Region

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Trade finance, despite being a relatively low risk type of lending, was among the first casualties of the reduced credit availability in the wake of the 2008 Global Financial Crisis (GFC). In the APEC 2009 Trade Finance Survey, 15 out of 17 members responding to the survey indicated that there were signs of trade finance shortages in their economies, with eight economies considering the problem to be moderately to very serious.

Towards the end of 2008, governments around the world enacted swift and coordinated monetary and fiscal policies to arrest the decline in economic growth and trade, with some implementing measures aimed specifically at reviving trade finance. These actions resulted in a noticeable improvement of trade finance by the third quarter of 2009. However, in the second half of 2011, bank funding conditions in Europe deteriorated as a result of weak economic performance and fiscal sustainability challenges. Concerns were again raised as to whether the provision of trade finance has been or will be affected given large scale deleveraging by European banks and stricter international banking regulatory standards.

As 2013 Chair of the APEC Finance Ministers' Process, Indonesia has made trade finance one of their priorities. The objective of this study, which is based around the APEC 2013 Trade Finance Survey, is to provide a comprehensive overview of the trends in trade finance since the 2008 GFC.

Findings

Recovery for trade finance since the 2008 GFC has been uneven

- An examination of the trends in the markets for selected trade finance products – such as letters of credit and factoring – reveals that the recovery for trade finance has been tepid and uneven.
- According to data provided by SWIFT, there was a downward trend in the global traffic of trade messages for two consecutive years in 2011 and 2012. The issuance of documentary credit in 2012, for example, was still below the level seen in 2010.
- For the APEC region, the issuance of documentary trade credit registered sharp declines. On the one hand, this may simply indicate that increasing competitiveness in the global trade arena has accelerated the shift away from traditional trade finance products such as letters of credit towards open account methods since they lessen the burden of risk for importers.
- Other possible causes may include a more cautious approach in issuing documentary trade credit adopted by banks in response to higher perceived risks brought about by increased volatility in the global financial system

and ongoing uncertainty over global economic conditions. Stricter risk management policies have resulted in a tightening of bank-intermediated trade finance supply, making it more difficult for firms to obtain trade finance.

- In the market for factoring, an open account trade finance instrument, there were signs that the APEC region was affected by the turmoil in Europe in late 2011. The value of factoring in the APEC region that is offered for international trade fell sharply by 20% in 2011.

APEC 2013 Trade Finance Survey suggests an improvement in the current state

- Eleven respondents to the APEC 2013 Trade Finance Survey reported that the volume of trade finance in their economies is above its pre-crisis level, four stated that the level is around its pre-crisis level, and one indicated that it is currently below its pre-crisis level.
- Some APEC members noted the importance of European banks in the supply of trade finance in their economy. Based on responses from 14 APEC members, four indicated that European banks provided more than 30% of the total volume in their economies prior to the 2008 GFC and three reported the share to be in the range of 10% to 30%.
- However, 80% of the APEC 2013 Trade Finance Survey respondents indicated that the retrenchment in European banks has reduced their share of the total supply of trade finance in their economy since 2010. The reduction was by less than 10% in the majority of the economies.

- APEC economies have benefited from increased lending for trade finance by domestic banks or by other international banks, with 80% of survey respondents reporting an increase in the provision of trade finance from non-European banks in their economies since 2010.
- However, a recent annual trade finance survey of bank representatives around the world found that there has been a substantial increase in the share of respondents stating that there had been a reduction in trade credit lines for corporate customers in 2013, and that there has been progressively fewer respondents reporting an increase in trade finance revenues since 2010.
- In addition, the implementation of new and enhanced prudential regulations, namely Basel III, will have significant consequences on the activities of the banking sector, most likely leading to a general reduction in overall lending capacity.
- By overstating its tenor and risk profile, Basel III is expected to have a disproportionately negative impact on the provision of trade finance, with many bankers stating that its implementation will most likely result in a reduction in their support for trade finance.
- The recent decision by the European Parliament to exempt trade finance instruments from some of the rules under Basel III for European banks could lead to regulatory arbitrage if other jurisdictions do not follow since it will therefore be less expensive for European banks to provide trade finance, putting banks in the Asia-Pacific region at a disadvantage.
- In comparison with domestic trade, international trade involves a greater number and a higher level of risks, stemming from the difficulty in evaluating counterparty risk in foreign locations and the greater probability of loss or damage during shipment. It also carries a larger financial constraint than domestic trade given its longer gap between production and payment.
- The larger financial cost and greater risk associated with international trade makes it more vulnerable to financial crises, during which credit lines for trade finance are often diminished. Empirical evidence shows that when a firm's credit lines are constrained, it reduces exports at a faster rate than domestic sales.

Trade finance is poised to improve, but risks remain

- APEC members are overwhelmingly positive on the outlook for trade finance. The APEC 2013 Trade Finance Survey reveals that 61% of 18 respondents expect the trade finance situation to improve through the end of 2014, with the rest expecting it to stay about the same.
- There are, however, significant downside risks to trade finance. Since the GFC, the availability and cost of credit has been supported by abundant liquidity associated with large-scale monetary easing policies. Any changes to this ultra-accommodative monetary stance could have an impact on the availability and the cost of lending, most likely impacting trade finance.
- The reduction in trade finance was among the attributing factors to the 10.5% contraction in export earnings in the APEC region in 2009. Since then, the uneven recovery for trade finance has also been accompanied by subdued growth in APEC trade. In 2012, trade value in the region grew at 3.3%, a sharp deceleration from the 28% growth registered in 2010.
- Securing access to trade finance is therefore important to ensure the robust trade growth necessary to support a sustainable recovery of the global economy.

Securing trade finance is critical for sustainable economic growth

- International trade has played as one of the key determinants in promoting economic growth in the APEC region. Since 1990, real GDP in the APEC region has grown by 80%, with an increase in exports contributing to nearly half of this growth.
- Trade finance is critical to trade for at least two reasons: (1) it provides the necessary insurance against counterparty risk; and (2) it provides working capital, which is vital to the maintenance of a healthy cash flow for businesses.

Trade finance can also play a role in promoting inclusive growth

- SMEs account for over 90% of all enterprises in every APEC economy. However, less than 15% of SMEs in most APEC economies are engaged in exporting. Enhancing and supporting trade finance will provide the much needed financing to help SMEs grow their operations and expand their markets internationally, ultimately providing a boost to trade growth.
- In the APEC 2013 Trade Finance Survey, 79% of respondents indicated that an increased risk aversion of financial institutions towards smaller companies is the most common impediment for SMEs to access trade finance. Given this general risk aversion, anecdotal evidence suggests that SMEs have not in fact been able to benefit from the abundant liquidity in the global economy that has held the cost of funding low. Thus, any reduction in trade finance will also disproportionately affect SMEs.
- Through export-import credit agencies, APEC members offer a range of products to support access to trade finance for the SMEs in their economy, including export credit insurance and working capital guarantees. Multilateral banks also play an important role in facilitating access to trade finance for SMEs in the region.
- Many APEC members responded to the impact of the 2008 GFC by implementing either new or enhanced measures to facilitate trade finance, with around half of the APEC 2013 Trade Finance Survey respondents introducing or enhancing their provision

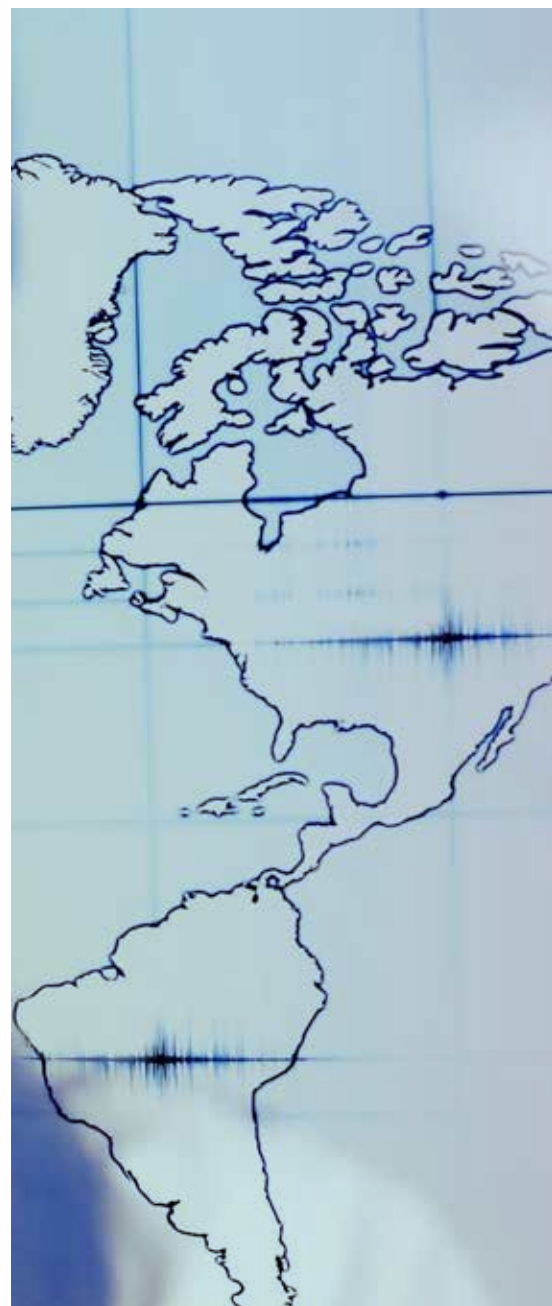
of export credit insurance and export credit in their economies since 2009.

- Even though the APEC region includes a wide range of members with varying levels of depth and sophistication in their domestic financial systems, publicly-provided trade finance facilities still have a role to play in all APEC economies.

Recommendations

APEC could address some of the current challenges to trade finance through the following:

- Monitor the volume of trade finance in the region as well as whether there are any issues in the ability of businesses to access trade finance, especially in certain sectors.
- Continue to facilitate access to trade finance for SMEs in the region by helping to build capacity in the export credit agencies of the developing economies and by acting as a forum for members to engage in the sharing of best practices.
- Regulators should take caution in their implementation of Basel III to ensure that banks in the region are not at a disadvantage in their provision of trade finance.
- Policymakers should implement policies that help to facilitate access to open account trade finance for both exporters and importers given its increasing use in international trade transactions.
- Conduct further research to assess the feasibility of developing trade finance instruments as an asset class.



Sustainable Economic Development

SMEs in the APEC Region

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Small and medium-sized enterprises (SMEs) are the backbone of business activities across the world, and together with large enterprises and multinationals they significantly contribute to the global economy. This policy brief offers a closer look at SMEs by first discussing some issues in defining SME and looking at how APEC members define SME. It then provides a snapshot of SMEs in the APEC region (by size; share to total enterprises, total employment and total exports; and economic contribution) and APEC's efforts in SME development. It concludes with some observations on areas that could advance APEC's work on SMEs.



Findings

- The definitions of SME are very heterogeneous across economies. APEC economies adopt different criteria when defining SME. In general, four criteria have been used: number of employees; sales (or revenue); assets; and capital (or investment). Some economies also use sector-specific criteria.
- SMEs account for over 97% of the total enterprises in every APEC member economy, and employ more than half of the workforce in most APEC economies. However, the role of SMEs might be understated due to the existence of SMEs in the informal sector, and which are not captured in the official statistics.
- A breakdown of SMEs by the sub-categories (small, medium or micro enterprises) in each economy shows an overwhelming majority of micro enterprises.
- The economic contribution of SMEs in the APEC region paints a heterogeneous picture. In China; Indonesia; Japan; Korea; and the United States, SMEs account for more than 50% of GDP. Had SMEs in the informal sector been taken into account, SMEs' economic contribution would be even greater.
- SMEs are generally less significant in terms of their contribution to direct exports. Only in China did SMEs' share in total exports exceed 50%. Besides direct exports, SMEs also engage in activities of indirect export.
- Although no aggregate data is currently available, based on SMEs' positive contributions in their respective economies, they could potentially play a significant role in the economic growth of the whole region.

Recommendations

The policy brief shed light on a number of areas that could advance APEC's work on SMEs:

- A common and regional definition for SME, to serve as a basis for compiling region-wide SME statistics and supplying data to APEC and member economies for use in setting targets, monitoring progress, and evaluating its initiatives and activities.
- Proper and credible channels to collect SME-related information and statistics from APEC members.
- Preferential treatment on taxation and social security requirement for SMEs in the informal sector, and fairness and equality in taxation systems.
- Continuing efforts to support SMEs in the access to international markets, and stepping up efforts to facilitate SMEs to export indirectly through global supply chains.



**Asia-Pacific
Economic Cooperation**

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