



Enhancing Value Chains

An Agenda for APEC

AUTHORS

Matthew P. Goodman
Scott Miller

*A Report of the CSIS Simon Chair in Political
Economy and Scholl Chair in International
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PRINCIPAL AUTHORS AND PROJECT DIRECTORS

Matthew P. Goodman
Scott Miller

CONTRIBUTING AUTHOR

David A. Parker

PROJECT COORDINATORS

Grace Hearty
Paul Nadeau
Clare Richardson-Barlow

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Center for Strategic & International Studies
1616 Rhode Island Avenue, NW
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202-887-0200 | www.csis.org

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4501 Forbes Boulevard
Lanham, MD 20706
301-459-3366 | www.rowman.com

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Acronyms

ABAC	APEC Business Advisory Council
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
CEO	chief executive officer
CPU	central processing unit
CREATE	Center for Responsible Enterprise and Trade
CTI	Committee on Trade and Investment
EAS	East Asia Summit
ETI	Enabling Trade Index
FTAAP	Free Trade Area of the Asia-Pacific
FTA	free trade agreements
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GOS	Group on Services
ICT	information and communication technology
IEG	Investment Experts Group
IT	information technology
ITA	information technology agreement
MFN	most-favored-nation (status)
OECD	Organization for Economic Cooperation and Development
RCEP	Regional Comprehensive Economic Partnership
SME	small and medium-sized enterprise
STAR	Services Trade Access Register
TFAP	trade facilitation action plan
TPP	Trans-Pacific Partnership
USTR	Office of the U.S. Trade Representative
WEF	World Economic Forum
WTO	World Trade Organization

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Robert Fauver
Murray Hiebert
Ann Katsiak
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Alexander Parle
Pamela Passman
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Executive Summary

Economic integration has been a focus of Asia-Pacific affairs for the last quarter century. To support and strengthen economic ties, governments in the region have pursued an array of integration initiatives, from the Asia-Pacific Economic Cooperation (APEC) forum launched in 1989 to bilateral and regional trade negotiations currently under way. APEC has been the most successful tool of regional trade and investment integration thus far and has the potential to continue bridging differences between various integration efforts in the region. The following report, produced by the Center for Strategic and International Studies (CSIS) with input from a wide variety of regional and topical experts, posits that developing a common, high-standard policy approach to value chains could pull together the various integration efforts, to the substantial economic benefit of the entire region. The report offers eight recommendations for a broad-based APEC initiative building on existing work in the region on supply chains and connectivity.

1 | Introduction

Economic integration has been both a reality and an organizing principle of Asia-Pacific affairs for the past 25 years. Trade and investment flows in the region have grown exponentially over this period and have been a major contributor to rising prosperity in a part of the world that accounts for roughly half of global population and output. To support and strengthen these growing economic ties, governments in the region have pursued an array of integration initiatives, from the Asia-Pacific Economic Cooperation (APEC) forum launched in 1989 to numerous regional and bilateral trade negotiations currently under way.

The membership, scope, and ambition of these undertakings vary considerably. This is perhaps inevitable in a region as economically and politically diverse as the Asia-Pacific. But it raises the prospect of a patchwork of inconsistent rules that could hamper rather than facilitate regional economic integration. There is also a concern that the divergent approaches could accentuate geopolitical strains in the region as countries line up in one economic camp or another.

As the oldest and arguably most successful forum for regional trade and investment integration, APEC could serve an important role over the next several years in bridging these differences. Since adopting the Bogor Goals of free trade and investment in 1994 and its more recent vision of a Free Trade Area of the Asia-Pacific (FTAAP), APEC has served for a quarter century as an incubator for regional integration efforts. The next three hosts of APEC—Indonesia this year, China next year, and the Philippines in 2015—have a unique opportunity to launch a process aimed at making key provisions of the region's numerous trade arrangements interoperable at a high standard.

The emergence of global value chains as the defining feature of 21st-century trade and investment patterns, in which a product idea is conceived in one country, inputs are procured and produced in others, assembly occurs in yet another, and the final product is shipped and marketed around the world, has fundamentally altered the stakes in trade negotiations. Rather than bargaining primarily for market access for their goods and services exports, countries must also ensure unrestricted value chains, that is, the smooth flow of investment, technology, and inputs across and behind borders. APEC has so far focused specifically on key cross-border logistics issues in work programs on supply-chain connectivity. For instance, APEC economies set a goal in 2010 of achieving a 10 percent reduction in the time, cost, and uncertainty of cross-border transactions by 2015. More

broadly, all of the regional arrangements under negotiation are likely to include an array of value-chain disciplines including logistics disciplines, services and investment liberalization, and information/communications technology facilitation. Consistency and high standards across these efforts would facilitate regional integration and promote better economic outcomes. For example, the 2013 *Enabling Trade* report by the World Economic Forum (WEF) has estimated that reducing key value-chain barriers worldwide halfway to established best practices could boost global gross domestic product (GDP) by \$2.6 trillion.¹

This report examines value-chain work under way in the Asia-Pacific region and offers recommendations for a broad-based initiative and work plan in APEC over the next few host cycles that would promote consistency and eventual interoperability of the various trade arrangements under negotiation in the region.

1. World Economic Forum (WEF), Bain and Company, and World Bank, *Enabling Trade: Valuing Growth Opportunities* (Geneva: WEF, 2013), 4, http://www3.weforum.org/docs/WEF_SCT_EnablingTrade_Report_2013.pdf.

2 | Value Chains: The New Reality of Trade

The rise of value chains is altering patterns of trade and competition as completely as the advent of steam power in early 1800s. Prior to the age of steam, the cost of shipping goods was a major barrier to international trade that enforced localized patterns of production, where the vast majority of what individuals consumed had to be produced relatively nearby. By dramatically slashing transportation costs, steam power enabled the first period of globalization in the late nineteenth century and helped to drive a 30-year boom in which trade doubled from 10 to 20 percent of global production.² Industrialization and the newfound ease of exporting to markets abroad allowed producers to capture greater economies of scale through the mass production of complex finished goods. At the same time, the challenge of coordinating complicated industrial processes kept manufacturing clustered in close-knit hubs and meant that finished manufactures and commodities continued to dominate international trade flows.³

Modern trade theory rose to describe this phenomenon, led by David Ricardo's comparative advantage and the famous example of trading Portuguese wine for English cloth. These ideas have translated directly into the policy arena and exerted a powerful influence over the evolution of the current international trading architecture anchored in the World Trade Organization (WTO) and focused on liberalizing trade in finished goods. But twentieth-century models of trade have become increasingly divorced from the realities of business in the twenty-first century.

The new model of trade can be described as "trade in tasks," where countries specialize in creating value at different stages within a larger international production chain.⁴ Just as steam power created the opportunity to geographically divide supply and demand, new communications technologies have allowed a further unbundling of production, freeing corporations to locate processes where they can be performed most efficiently. This has created gains for consumers as well as new routes to development, allowing

2. Frederic S. Mishkin, *The Next Great Globalization: How Disadvantaged Nations Can Harness Their Financial Systems to Get Rich* (Princeton, NJ: Princeton University Press, 2008), 2.

3. For a further discussion of what has been termed "globalization's second unbundling," see Richard Baldwin, "Trade and Industrialisation after Globalisation's 2nd Unbundling: How Building and Joining a Supply Chain are Different and Why it Matters" NBER Working Paper 17716, National Bureau of Economic Research, December 2011, 7, http://www.nber.org/papers/w17716.pdf?new_window=1.

4. Gene M. Grossman and Esteban Rossi-Hansberg, "Trading Tasks: A Simple Theory of Offshoring," *American Economic Review* 98, no. 5 (December 2008).

underdeveloped nations to gain access to advanced technology and managerial know-how by entering existing value chains at stages where they possess comparative advantage. As a result, complex final goods have increasingly become “packages of many nations’ productive factors, technology, social capital, and governance capacity” along global value chains.⁵

The iPod production chain typifies this new pattern of trade. Designed by Apple at its headquarters in Cupertino, California, the iPod incorporates inputs sourced from throughout the Asia-Pacific: the display comes from Japan, the memory from Korea, the central processing unit (CPU) is made in America, and the video processors are manufactured in Singapore and Taiwan. All of these inputs (including a Chinese-made hard drive designed in Japan) converge on China, where a Taiwanese company oversees the assembly of the final product in factories along the coast of the mainland. The final product is packaged and shipped for distribution, often returning to its starting point in the United States.⁶

The expansion of trade within value chains like the one described above is particularly dramatic in “Factory Asia,” where traditional trade statistics conceal the underlying patterns of transactions. As the iPod example illustrates, many electronic goods are assembled in China before being exported throughout the world. Despite the fact that assembly generally constitutes a small share of the good’s total value, within China’s balance of payments the price of the final good is counted as a Chinese export to the destination country. However, when China’s share of the product’s value is measured instead, the 2009 trade imbalance between the United States and China drops by over \$60 billion, or one-third of the total.⁷

The importance of value chains also helps explain the proliferation of bilateral free trade agreements (FTAs) in the region—76 concluded as of April 2013—as economies seek to enhance their competitiveness by building individual low-barrier networks. Yet these negotiations have often been conducted without a full appreciation of the importance of trade in tasks. Many FTAs focus on tariffs and market access for finished goods and cope with political pressures through mercantilist bargaining without a clear picture of the underlying commercial realities. Moving forward, value chains deserve greater attention: one recent study estimated that reducing value-chain barriers, even under conservative assumptions, could boost global GDP by nearly 5 percent.⁸ These gains are all the more impressive when set against the estimated benefit of reducing tariffs to zero worldwide: just 0.7 percent of global GDP.⁹

5. Baldwin, “Trade and Industrialisation,” 7.

6. Dick K. Nanto, “Globalized Supply Chains and U.S. Policy,” Congressional Research Service, January 16, 2009.

7. Organization for Economic Cooperation and Development (OECD), *Interconnected Economies: Benefiting from Global Value Chains* (Paris: OECD, 2013), 60.

8. WEF’s *Enabling Trade* estimates \$2.6 trillion in global GDP gains from reducing value-chain barriers halfway to global best practices in two out of four key areas identified: border administration and telecom and transport infrastructure. Gains from reducing market access barriers and improving business environments are not included in the estimate. For more details, see WEF, *Enabling Trade*, 13–24.

9. WEF, *Enabling Trade*, 13–24.

3 | The Policy Gap on Value Chains

The increasing importance of trade within value chains presents both opportunities and challenges for policymakers. The effect of trade barriers, whether in the form of tariffs or other border measures, can be compounded in value chains, principally because of the way value is added via trade in intermediate goods. In this new model, imports become an essential component of exports, making tariffs and nontariff barriers a functional tax on exports. Export restrictions can be similarly damaging, limiting the value-adding processes a country is likely to host and reducing its overall competitiveness. In short, the negative effects of trade protection can multiply in value chains as components cross borders multiple times. Arrangements to reduce this multiplier effect (for example, through free trade agreements or export processing zones) are a valuable contributor to value-chain efficiency.

Yet value-chain trade presents a challenge to governance. The international production networks that are transforming global trade are based on a different business model than the one that underpins the General Agreement on Tariffs and Trade (GATT) and its subsequent iterations. The GATT establishes disciplines for what are presumed to be arm's-length transactions between unrelated parties in different political jurisdictions. By contrast, the cross-border flows in value-chain trade are essentially highly coordinated movements of goods, investment, services, knowledge, and people by firms and their business partners; it is the constant exchange of knowledge that makes value-chain trade different in kind from the traditional exchange of final goods described by Ricardo.

Consequently, the policy framework and capabilities a country requires to reap the full benefits of value chains differ from those required for trade in finished goods.¹⁰ Firms are looking for a seamless connection to suppliers through efficient movement of people, data, and ideas, as well as security of their firm-specific know-how, managerial and technical expertise. This raises the opportunity cost to countries of enacting discriminatory policies that inhibit the entry and operation of foreign firms, particularly those specializing in services that enhance physical and digital connectivity. Similarly, unique or poorly designed regulatory policies that raise costs for foreign and domestic firms can dramatically reduce a country's competitiveness and inhibit the process of value-chain integration.

It is clear to most observers that the “first best” solution would be a multilateral agreement that established new disciplines appropriate to today's value chain-based

10. Baldwin, “Trade and Industrialisation,” 5–8.

international economy. Yet the GATT/WTO system has so far been unable to grasp this mantle. The Doha Development Agenda, launched in 2001, has failed to conclude even a basic agreement on trade facilitation—measures such as reducing red tape and expediting customs clearance that lower costs and delays associated with border crossing. While there is some hope that an agreement in this area, worth an estimated \$960 billion in global GDP gains, will be reached at the December 2013 WTO ministerial in Bali, it remains to be seen whether members can overcome reluctance to conclude a stand-alone agreement and resolve concerns over special and differential treatment.¹¹

Because of this long stalling at the multilateral level, and because most value chains are regional, the path of least resistance has been bilateral or regional agreements to liberalize tariffs, regulation, transport, investment, and communication. From this perspective, value chains are the driving force behind the “noodle bowl” of bilateral and regional trade and investment agreements. These have yielded important gains in prosperity, but the multiplicity of rules and disciplines simultaneously introduces new frictions to the system.

These problems could be further compounded by the two large regional trade arrangements currently being negotiated in the Asia-Pacific. While both offer significant welfare gains, without deliberate coordination there is the potential that each will adopt very different approaches to value-chain issues.

The Trans-Pacific Partnership (TPP). TPP negotiations were formally launched in March 2010 by the United States, Australia, Peru, Vietnam, and four smaller Asia-Pacific economies (Brunei, Chile, New Zealand, and Singapore) that had earlier reached their own free trade pact, the so-called P4 agreement. With the subsequent entry of Malaysia, Mexico, Canada, and Japan, TPP now includes 12 countries that together account for nearly 40 percent of global GDP and roughly a third of world trade.¹² Members have committed to negotiating a “comprehensive, next-generation regional agreement” that both liberalizes trade and investment and addresses new 21st-century challenges.¹³ According to one estimate, a successful TPP agreement will by itself lead to annual global GDP gains of \$295 billion in 2025.¹⁴ Following 18 rounds of negotiations, TPP participants have set the ambitious goal of reaching agreement by the end of 2013.

The Regional Comprehensive Economic Partnership (RCEP). Formally launched in November 2012, RCEP brings together the 10 countries of the Association of Southeast Asian Nations

11. Gary Hufbauer and Jeffrey Schott, with Cathleen Cimino and Julia Muir, *Payoff from the World Trade Agenda 2013* (Washington, DC: Peterson Institute for International Economics, April 2013), <http://www.iie.com/publications/papers/hufbauerschott20130422.pdf>.

12. Office of the U.S. Trade Representative (USTR), “Trans-Pacific Partnership Negotiations Maintain Strong Momentum,” press release, May 24, 2013, <http://www.ustr.gov/about-us/press-office/press-releases/2013/may/tpp-negotiations-strong-momentum>.

13. USTR, “Trans-Pacific Partnership Leaders’ Statement,” press release, November 12, 2011, <http://www.ustr.gov/about-us/press-office/press-releases/2011/november/trans-pacific-partnership-leaders-statement>.

14. Peter A. Petri, Michael G. Plummer, and Fan Zhai, “Adding Korea and Japan to the TPP,” March 7, 2013, <http://asiapacifictrade.org/wp-content/uploads/2013/05/Adding-Japan-and-Korea-to-TPP.pdf>. Gains are measured in 2007 U.S. dollars. This scenario assumes Korea also joins the agreement in 2014.

(ASEAN) with 6 other Asian powers: China, Japan, Korea, Australia, New Zealand, and India. The stated goal of RCEP is to establish a “modern, comprehensive, high quality, and mutually beneficial economic partnership” that will deliver “significant improvements over the existing ASEAN+1 FTAs.”¹⁵ If successfully completed, and provided the agreement is comprehensive and high-standard, RCEP would create a free trade area covering roughly one-third of global GDP and offering significant annual global welfare gains, estimated by one study at \$644 billion in 2025.¹⁶ Member countries held a first round of talks in Brunei in early May and are seeking to reach agreement by the end of 2015.

Alongside TPP and RCEP, other regional trade agreements are also continuing to advance, including the trilateral China-Japan-Korea FTA and a host of bilateral arrangements.¹⁷ This compounds the risk that a hodgepodge of obligations will proliferate where a single high standard would better serve the interest of traders and governments.

Parties across these negotiations are clearly aware of the need to address value-chain issues and are working to address them in their separate talks. While the actual text is not yet public, TPP members have announced that the agreement will include chapters promoting regulatory coherence and standardizing arrangements related to customs, investment, cross-border services, and other areas critical to capturing the full benefits of 21st-century trade. Having started more recently, the full range of measures likely to emerge in RCEP negotiations is unclear, but initial documents have explicitly acknowledged the goal of facilitating participants’ engagement in regional and global value chains.

Given the focus in this area and the potential gains at stake, the growth of divergent or inadequate standards would clearly constitute a major missed opportunity, one that would disproportionately impact value-chain trade and the attendant benefits in important areas including development, small and medium enterprise productivity, and overall economic growth.

This creates the opportunity and imperative to develop a high-standard Asia-Pacific architecture that deals with value-chain barriers. A recent macroeconomic study indicates that the potential economic benefits of Asia-Pacific economic integration via comprehensive TPP and RCEP arrangements are large: eventually, they could produce annual GDP gains on the order of \$1.3 to \$2.4 trillion by 2025.¹⁸ Importantly, the authors observe that

15. Regional Comprehensive Economic Partnership (RCEP), “Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership,” November 2012, <http://www.iadb.org/intal/intalcdi/PE/CM%202013/11581.pdf>.

16. Government of Singapore, Ministry of Trade and Industry, “Factsheet on the Regional Comprehensive Economic Partnership (RCEP),” November 2012, http://www.fta.gov.sg/press_release%5CFACTSHEET%20ON%20RCEP_final.pdf.

17. According to the Asian Development Bank’s Asia Regional Integration Center, there are currently 53 free trade agreements involving at least one ADB member under negotiation and another 61 either proposed or under consultation and study as of June 2013.

18. Peter A. Petri, Michael G. Plummer, and Fan Zhai, *The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment* (Washington, DC: Peterson Institute for International Economics, November 2012).

“the templates used [to administer the agreements] matter”; deeper liberalization would yield greater economic benefits. Further illustrating the need for coherence is the overlapping membership of many agreements; there are seven economies that are parties to both RCEP and TPP negotiations. For these economies, a common or interoperable set of disciplines, geared to the highest possible standard, would be of substantial interest as a way to fully capture operational efficiencies.

4 | A Broader Approach

Developing a broad, high-standard Asia-Pacific approach to value-chain facilitation offers a variety of benefits for countries across the region and at all levels of development. In order to maximize regional economic growth and integration, it should cover four key areas: trade facilitation, investment rules, digital economy and connectivity, and regulatory environment. Work organized according to these four streams will provide a robust model to ensure basic coherency on value chain–critical elements of future regional agreements.

Trade Facilitation

Trade facilitation refers to improving the procedures and controls governing the movement of goods across borders. Many existing country policies and practices at the border are poorly designed and create significant barriers to trade; the Organization for Economic Cooperation and Development (OECD) estimates that up to 7 percent of the value of internationally traded goods and services is absorbed by the cost of documentation alone.¹⁹ Improvements in trade facilitation, such as enhancing transparency in customs and border procedures, help reduce the cost and improve the efficiency of exchanging goods across borders while safeguarding legitimate regulatory objectives. To this end, many economies view efficient, predictable customs regimes as a source of competitive advantage in attracting production investment. Research indicates that improvements in trade facilitation hold large potential benefits to trade and GDP growth.²⁰

Existing disciplines governing the multilateral system are found in GATT Article V (freedom of transit), Article VIII (fees and formalities connected with importation and exportation), and Article X (publication and administration of trade regulations). Many FTAs deepen these disciplines beyond the GATT level of commitment, although it is not yet clear what new standards will be adopted in TPP, RCEP, and other bilateral FTAs under consideration. Additionally, the WTO is negotiating improvements to trade facilitation disciplines on a multilateral basis as part of the ongoing Doha Development Agenda. Trade ministers will meet in Bali in December 2013, and it is possible that a new agreement on trade facilitation may advance to conclusion.

19. World Trade Organization (WTO), “Trade facilitation,” http://www.wto.org/english/news_e/brief_tradefa_e.htm.

20. Hufbauer and Schott, *Payoff from the World Trade Agenda 2013*.

The gold standard in assessing trade facilitation outcomes are the measures put forth by the World Economic Forum (WEF) in its Enabling Trade Index (ETI), which identifies three value-chain barriers that can be reduced through improved trade facilitation practices: the efficiency of customs administration (speed, ease, predictability, and quality of service); efficiency of import-export procedures (interagency coordination, multiple regulatory clearance requirements); and transparency of border administration (corruption, process inconsistency).²¹

Investment Rules

Foreign direct investment is a critical link in regional and global production chains. Rules in this area can impede or facilitate the smooth operation of value chains, not only as they apply to production facilities but also as they impact two other vital areas: transport and communications infrastructure and intermediate distribution/transit services. Quality transport infrastructure includes airports, roads, and seaports that are adequate for traffic and properly maintained. Given the importance of transit speed, predictability, and seamless connection to value-chain operators, port infrastructure separates strong country performers from the weak. Economies with stable, fair policies governing the treatment of foreign investment have an easier time attracting needed infrastructure capital. Similarly, rules that guarantee nondiscriminatory treatment of foreign-owned services firms can significantly improve the quality and domestic availability of transport and communications/information technology (IT) services. Having the right framework of rules in place for infrastructure and services investment are critical determinants of a country's ability to attract high-value-added activities such as advanced manufacturing, research, and design. Differences in rules in these areas are a major reason that the average time for a container to ship between developing APEC economies is double that for shipments between advanced APEC economies.

Many FTAs in force among Asia-Pacific economies contain commitments on investment, adding to the substantial existing network of bilateral investment treaties and FTAs with investment chapters. Ensuring that these chapters employ consistent high standards and common language where possible can help boost cross-border flows of investment throughout the region. As the negotiations move forward, one potential resource is contained in the nonbinding investment principles updated by the APEC Investment Experts Group (IEG) in 2011. These principles offer ready-to-use language for establishing investment disciplines according to internationally recognized standards. Tools are also available for advancing best practices in important new areas, such as measures for promoting the public-private infrastructure investment partnerships critical to meeting demand for investment capital in the Asia-Pacific.

21. For more details on the Enabling Trade Index (ETI), see Annex 1.

Digital Economy and Connectivity

Efficient value chains require seamless connection between customers, suppliers, and logistics operators. Unreliable communications and technology infrastructure can add uncertainty and complexity to a firm's network, making it difficult to track materials and coordinate deliveries. Requirements for paper documentation instead of electronic customs processing also add time, cost, and uncertainty. These delays can quickly mount, especially because the average customs transaction “involves 20–30 parties, 40 documents, 200 data elements (30 of which are repeated at least 30 times) and the re-keying of 60–70 per cent of all data at least once.”²²

Supply-chain integrity is a major concern for multinational firms. Production networks rely on trusted parties, and supply-chain disciplines must operate in a way that limits illicit effects. Two specific areas requiring attention are counterfeits and trade secret protection. Extensive, multi-country value chains open numerous points of vulnerability where counterfeit components can infiltrate products, risking harm to end users. Governments can adopt regulations to stem the flow of illicit components, but firms must also act to implement solutions.²³ Trade secrets, especially unique commercial and process knowledge, are necessarily shared among value-chain business partners. Firms with specialized know-how are exposed to the risk of misappropriation, especially when working with suppliers in countries with weak rule of law. Part of value-chain connectivity is applying best practices for securing unique knowledge.²⁴

Addressing digital economy and connectivity issues is an increasingly important challenge for supporting regional value chains, but work on developing measures suitable for incorporating into FTAs is a relatively recent phenomenon. So far, RCEP members have announced that they will approach issues related to e-commerce as part of a broader effort to improve economic and technical cooperation. TPP negotiators are considering how to deal with digital economy issues in an economy-wide context, including information access and transfer, coverage of IT-enabled services, and nondiscriminatory treatment of digital goods. In order to advance toward interoperability and high standards, work is needed to identify the specific elements that apply to value-chain connectivity, and then explore the extent to which these elements can be incorporated in existing work programs on supply-chain connectivity, such as the work of the APEC Committee on Trade and Investment (CTI) on supply-chain choke points.

22. WTO, “Trade facilitation.”

23. Center for Responsible Enterprise and Trade (CREATE), *Health & Safety Risks from Counterfeits in the Supply Chain* (Washington, DC: CREATE, October 2012), http://www.create.org/sites/default/files/CRE_12_00007_Whitepaper_r15.pdf.

24. CREATE, *Trade Secret Theft: Managing the Growing Threat in Supply Chains* (Washington, DC: CREATE, May 2012), http://www.create.org/sites/default/files/CREATE_White-Paper_Trade-Secret-Theft_Final-e.pdf.

Regulatory Environment

Many barriers to value-chain efficiency arise from an economy's regulatory environment. For instance, regulation can limit the availability of trade finance, create difficulties in contracting with port service firms, and add complexity and cost to firms attempting to operate production networks. In some cases, regulations that appear nondiscriminatory can have the effect of excluding economies from performing steps in a value chain, such as prohibitions on the import of certain materials or product-specific regulations that restrict access to intermediate goods. These regulatory hurdles are particularly onerous for small and medium-sized enterprises (SMEs); the WEF estimates that measures to simplify regulatory compliance standards for international trade conducted over the Internet could increase cross-border SME sales by 60 to 80 percent.²⁵

The TPP is developing a set of cross-cutting disciplines on regulatory coherence, building on regulatory cooperation work begun in APEC. Adopting regulatory practices consistent with recognized best practices is one option for economies seeking self-help solutions to boosting their value-chain competitiveness. The challenge is identifying and disseminating these practices. Work in this area is continuing in APEC.

25. WEF, *Enabling Trade*, 4–7.

5 | The Role of APEC

The simultaneous negotiation of two large regional agreements alongside the new reality of value chain–driven trade provides an important opportunity for APEC to play its traditional role as an incubator for efforts at promoting economic integration. APEC has assembled a broad array of competencies and built habits of cooperation among members that have played a critical role in allowing “Factory Asia” to grow and flourish over the past quarter century. Seven APEC economies (Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, and Vietnam) are parties to both TPP and RCEP negotiations, creating further incentives within APEC to advocate for adoption of complementary or identical obligations in both agreements.

APEC has long served as both a forum for bridging gaps among members across the development spectrum and as a tool for clearing away the tangled underbrush of impediments to regional trade. Central to this project have been the Bogor Goals, announced at the 1994 APEC summit in Bogor, Indonesia, which saw leaders at the highest political level agree to pursue free trade among industrialized members by 2010 and among all members by 2020.²⁶ Guided by this shared ambition, APEC members have cooperated to progressively lower average regional tariff rates to 5.8 percent and build an array of leading-edge initiatives, committees, and working groups dedicated to enabling the free flow of goods, services, ideas, and investment throughout the region. These efforts have been instrumental in supporting a doubling of GDP among members since APEC’s founding in 1989 and a fivefold increase in regional trade.

APEC has also demonstrated the ability to “get stuff done,” whether by mustering political impetus to push forward agreements at the multilateral level or by pioneering innovative, consensus-based approaches among APEC members to addressing next-generation trade and investment issues. In 1997 APEC helped unite leaders to drive forward the 1997 WTO Information Technology Agreement (ITA), which lowered tariffs and promoted efficient trade in goods critical to supporting connectivity and the IT revolution. Similarly, when talks on advancing trade in environmental goods and services stalled at the multilateral level, APEC members were able to come together at the 2012 APEC summit in Vladivostok, Russia, and agree on the first-ever list of 54 environmental goods that would be subject to a tariff cap of 5 percent.

26. APEC, “2010 Leaders’ Declaration: Yokohama Declaration: The Yokohama Visions: Bogor and Beyond,” November 13, 2010, http://www.apec.org/Meeting-Papers/Leaders-Declarations/2010/2010_aelm.aspx.

Value chains are another critical area where APEC has been consistently ahead of the curve. Responding to the increasing importance of trade in tasks, leaders at the 2001 summit in Shanghai set a target of reducing average transaction costs in member economies by 5 percent over five years through a trade facilitation action plan (TFAP).²⁷ Given the technical demands of effective value-chain facilitation, this was no small task, especially for many emerging economies where capacity was especially low and costs especially high. To succeed, APEC leveraged its unique reach to bring together groups ranging from customs officials to private-sector experts, building capacity, raising awareness, and reducing barriers by 5 percent over the first five-year time frame, and by a further 5 percent from original levels through the second TFAP (2006–2010).

As members' understanding of value chains has grown, so has the scope of APEC's work program. APEC held a supply-chain connectivity symposium in 2009 that served as the basis for identifying eight trade-impeding bottlenecks, ranging from inefficient customs procedures and lack of regulatory coherence to inefficient transit infrastructure. A year later, the Yokohama Leaders' Declaration set a goal of improving supply-chain performance by 10 percent across APEC by 2015, using APEC's supply-chain connectivity framework to reduce the time, cost, and uncertainty of moving goods and services through the region.²⁸ These initiatives have drawn enthusiastic support from across APEC, as members have recognized their common interest in cooperating, given that already 62.5 percent of total manufacturing exports in East Asia are related to value chains.²⁹

27. APEC, "2001 Leaders' Declaration: Shanghai Declaration: Meeting New Challenges in the New Century," October 21, 2001, http://www.apec.org/Meeting-Papers/Leaders-Declarations/2001/2001_aelm.aspx.

28. APEC, "2012 APEC Ministerial Statement: Annex B—Towards Reliable Supply Chains," September 5, 2012, http://apec.org/Press/News-Releases/2012/~/link.aspx?_id=08D3FA5AB5D8478B86BF1966EB11D79E&_z=z.

29. Razeen Sally, "Global value chains, trade policy and Asia," East Asia Forum, June 13, 2013, <http://www.eastasiaforum.org/2013/06/13/global-value-chains-trade-policy-and-asia/>.

6 | Recommendations

APEC has been a consistent leader in enabling value chains to grow and flourish throughout the region, working consistently to improve efficiency and resiliency by harnessing the combined expertise of governments, the private sector, and the international community. Building on its strong track record and ongoing efforts to address supply-chain choke points, now is the time to consolidate and expand on existing APEC work streams within this area.

APEC should broaden and elevate its work on supply chains and begin identifying a set of nondiscriminatory, nonexclusive practices that will improve value-chain performance and support further economic integration across the Asia-Pacific region. Such an effort would be fully consistent with—indeed would give further substance to—the broader theme of regional connectivity pursued by APEC members in recent years. We recommend that over the next three host cycles under the leadership of Indonesia, China, and the Philippines, APEC launch an initiative to develop a common, high-standard Asia-Pacific approach to value-chain connectivity that builds upon existing work and helps ensure the interoperability of current and future trade agreements in the region.

Elements of this initiative could include the following eight recommendations.

Substantive Recommendations

1. *Trade facilitation: focus supply-chain connectivity actions on high-standard customs and border measure cooperation.* A 2011 presentation to the APEC Business Advisory Council (ABAC) by the USC Marshall School of Business identified transaction cost reduction opportunities from simplified documentation and electronic systems.³⁰ APEC can support the adoption of best practices in all economies' customs and border measures, but the supply-chain connectivity work program, being coordinated through APEC's Committee on Trade and Investment (CTI), can give special attention to developing and promoting harmonized customs documents and working to transfer the best-in-class information systems and technology-based solutions.³¹ Work

30. University of Southern California (USC) Marshall School of Business ABAC Team 2011, "APEC Supply Chains: Identifying Opportunities for Improvement," APEC Business Advisory Council, 2011, <http://www-marshall.usc.edu/assets/148/24586.pdf>.

31. APEC Policy Support Unit, *The 2013 Interim Assessment for Supply Chain Connectivity Framework and Action Plan* (Singapore: APEC, March 2013), http://publications.apec.org/publication-detail.php?pub_id=1411.

could proceed with an eye toward achieving common documentation requirements and systems for goods subject to various preferential agreements as well as most-favored-nation (MFN) transactions. While the CTI has principal responsibility for oversight of the individual action plans, this effort would also provide an opportunity to engage the Asia-Pacific private sector and potentially serve as a basis for partnership between regional governments and the private sector on implementation.

2. *Investment disciplines: deepen value-chain-related investment practices.* APEC's Investment Experts Group (IEG) has already done useful work on developing investment principles. The IEG should adopt a work program focused specifically on value chain-related investment, including transport and communications infrastructure. Most APEC economies have entered into bilateral investment protection treaties, but these agreements show wide variation with regard to access to specific sectors and other restrictions on the movement of capital. Asia-Pacific economies have already adopted a wide array of investment protections. APEC can assist in demonstrating the benefits of policies that reduce risk premiums and promote private investment flows.
3. *Build stronger digital economy and connectivity disciplines.* CTI's program on supply-chain connectivity has delivered progress on paperless trading and e-commerce applications, especially the adoption of electronic certificates of origin. It has also increased attention to matters of supply-chain visibility. The future CTI work program should take into account the technological advancements now available and work for early adoption of improved methods. There are several opportunities for APEC economies to accelerate progress on the connectivity agenda, whether by adopting work from ASEAN or intensifying efforts on implementing choke point diagnostics. Further, the work on supply-chain connectivity has encouraged collaboration with private-sector experts. This partnership should be enhanced with respect to the digital customs environment and supply-chain integrity.
4. *Deepen regulatory cooperation using the best of FTA disciplines.* Since 2011 APEC has undertaken useful work on regulatory cooperation. The Trans-Pacific Partnership (TPP) is expected to have a separate chapter on "Regulatory Convergence" and the Regional Comprehensive Economic Partnership (RCEP) negotiators have affirmed the role of regulatory cooperation as a key component of regional architecture.³² We recommend that APEC focus its regulatory cooperation actions on the identification of specific regulations affecting value-chain performance with a view toward voluntary adoption of regulatory practices that boost value-chain performance and efficiency. Specifically, extensive work by the CTI to create diagnostics on choke points would provide an excellent starting point for identifying specific regulatory practices affecting value-chain performance. However, regulatory barriers to

32. RCEP, "Joint Statement, the First Meeting of the Trade Negotiating Committee," May 9–13, 2013, <http://www.asean.org/news/asean-statement-communicues/item/regional-comprehensive-economic-partnership-rcep-joint-statement-the-first-meeting-of-trade-negotiating-committee>.

value-chain performance are typically industry specific while frequently involving multiple regulatory agencies. Governments must take a strategic approach to regulatory barriers, with an understanding of the effect on current and potential future industries.

5. *Expand the STAR database.* The APEC Group on Services (GOS) has undertaken work on the Services Trade Access Register (STAR), which provides information to service providers on behind-the-borders requirements. We recommend that the GOS catalog value chain-related service requirements in all 21 APEC economies. This is particularly important for enhancing small and medium-sized enterprise (SME) export competitiveness in services and their ability to engage regional value chains.

Process Recommendations

6. *Promoting Value Chain Connectivity in 2014.* The Bali Leaders' Declaration captured the goal of value-chain connectivity for APEC. China now has the mandate to explore a comprehensive initiative in this area, with a specific reference to high-standard interoperability of regional trade agreements including RCEP and TPP. Ideally, this statement would build upon paragraph 34 of the 2013 Trade Ministers' Declaration, which identified the need for coherence, building upon actions taken in supply-chain connectivity, trade facilitation, good regulatory practice, and movement of persons.³³
7. *Quarterly updates on RCEP and TPP by the CTI.* The CTI has long monitored the progress of regional trading arrangements entered into by APEC member economies. As an affirmative part of its agenda, we recommend that the CTI include, as a part of their normal quarterly meetings, a review of both TPP and RCEP negotiations, with a focus on value chain-related issues. The review process could usefully be led by the seven APEC economies who are parties to both RCEP and TPP negotiations.
8. *Engage supply-chain experts.* To achieve the ultimate goal of a Free Trade Area of the Asia-Pacific, APEC should act now to deepen its engagement with experts on value-chain performance, including the World Bank and the World Economic Forum (WEF).³⁴ The CTI has already made effective use of World Bank expertise to diagnose choke points. Additionally, the 2013 WEF *Enabling Trade* report makes a critical contribution to advancing global understanding of value chains and developing technical standards for improvement. By expanding on its existing cooperation, particularly from private-sector experts from ABAC and WEF, APEC will ensure that its work stream continues to incorporate the latest value chain-related research and insights.

33. APEC, "2013 Meeting of APEC Ministers Responsible for Trade," April 21, 2013, http://www.apec.org/Meeting-Papers/Ministerial-Statements/Trade/2013_trade.aspx.

34. WEF, *Enabling Trade*.

7 | Conclusion

The economic landscape of the Asia-Pacific is shifting dramatically and there is an opportunity to shape the regional economic architecture for many years to come. When completed, TPP and RCEP will be among the largest free trade areas in the world. They will overlap to cover trade and investment in a geographic area stretching from New Delhi to New York, creating the environment that will govern the future of vital value chains across the globe.

With its consensus-based approach, technical competence, and strong track record, APEC is the logical site for ensuring high-standard interoperability between these evolving approaches. Leaders at the 2013 APEC summit in Bali endorsed the goal of promoting value-chain connectivity within APEC. The aim for 2014 should be to establish a mandate to pursue work on interoperability of high-standard value chain disciplines during China's host year, a work plan that can be further developed by the Philippines in 2015.

Reducing value-chain barriers worldwide halfway to established best practices presents the opportunity to capture \$2.6 trillion in global GDP gains.³⁵ Accounting for nearly 50 percent of global output, Asia-Pacific economies stand to capture a significant portion of these gains if they act now to ensure interoperability in value-chain disciplines at a high standard. APEC is ideally situated to facilitate this process.

35. WEF, *Enabling Trade*, 4.

Annex 1. Enabling Trade Index and Existing APEC Work Streams

Since its first release in 2008, the Enabling Trade Index (ETI) has been at the core of the World Economic Forum’s annual *Global Enabling Trade Report*.³⁶ It provides a toolbox for countries seeking to reduce value-chain barriers at home and for companies considering investments abroad. In 2012 the ETI assessed 132 economies’ performance within four broad areas critical to lowering value chain barriers: market access, border administration, infrastructure, and business environment.

The table below summarizes these four ETI pillars and subcategories within each pillar. Marked boxes indicate areas that will be affected by planned the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP) disciplines and where there are currently active APEC work programs. As this demonstrates, the APEC work program fits squarely within the outlines of the ETI and is currently active in nearly all areas where TPP and RCEP negotiations are focusing.

Comparison of Supply Chain Work in TPP, RCEP, and APEC

<i>Enabling Trade Index Pillars</i>	<i>TPP/RCEP Discipline</i>	<i>APEC Work Program</i>
Market Access		
Domestic and foreign market access	X	
Border Administration		
Efficiency of customs administration	X	X
Efficiency of imports/exports procedures	X	X
Transparency of border administration	X	X

36. See, for example, Robert Z. Lawrence et al., editors, *The Global Enabling Trade Report 2012: Reducing Supply Chain Barriers* (Geneva: World Economic Forum, 2012), http://www3.weforum.org/docs/GETR/2012/GlobalEnablingTrade_Report.pdf.

<i>Enabling Trade Index Pillars</i>	<i>TPP/RCEP Discipline</i>	<i>APEC Work Program</i>
Transport and Communications Infrastructure		
Availability and quality of transport infrastructure		
Availability and quality of transport services		
Availability and use of ICTs	X	X
Business Environment		
Regulatory environment	X	X
Physical security		

Annex 2. CSIS Conference Agenda

Asian Architecture Conference @ CSIS

On September 12, 2013, the Scholl Chair in International Business, the Simon Chair in Political Economy, and the Sumitro Chair in Southeast Asian Studies hosted the Asian Architecture @ CSIS conference to discuss security and economic issues in the Asia-Pacific ahead of the East Asia Summit (EAS) in Brunei and the Asia-Pacific Economic Cooperation (APEC) summit in Indonesia, both in October 2013. Panelists discussed how APEC contributes to regional integration, with an emphasis on connectivity at the ministerial level and at the tactical level, particularly in terms of connecting the private and public sectors. You can watch the full conference at <http://csis.org/event/asian-architecture-conference-csis>. The conference agenda follows.

0930 Registration of Participants

1000 Welcoming Remarks:

Mr. Scott Miller
Senior Advisor and Scholl Chair in International Business
CSIS

1005 APEC Business Advisory Council Perspective:

Mr. Bart Peterson
Senior Vice President, Corporate Affairs and Communications
Eli Lilly

Introduction:

Ms. Monica H. Whaley
President
National Center for APEC

1025 Opening Remarks:

The Honorable Kurt M. Campbell
Chairman and CEO
The Asia Group

Moderator:

Mr. Ernest Z. Bower
Senior Advisor and Sumitro Chair on Southeast Asian Studies
CSIS

1100 Panel Discussion: Security Issues in East Asia Summit

Panelists:

His Excellency Nguyen Quoc Cuong
Ambassador of the Socialist Republic of Vietnam to the United States
Embassy of the Socialist Republic of Vietnam

Mr. Vikram Singh
Deputy Assistant Secretary of Defense for South and Southeast Asia
Department of Defense

Dr. Michael J. Green
Senior Vice President for Asia and Japan Chair, CSIS
Associate Professor, Georgetown University

Moderator:

Mr. Ernest Z. Bower
Senior Advisor and Sumitro Chair on Southeast Asian Studies
CSIS

1200 Luncheon

1215 Luncheon Keynote Speaker

The Honorable Scot Marciel
Principal Deputy Assistant Secretary for East Asian and Pacific Affairs
U.S. Department of State

Moderator:

Mr. Murray Hiebert
Deputy Director and Senior Fellow
CSIS Sumitro Chair for Southeast Asia Studies

1300 Panel Discussion: Economic Issues in EAS/APEC

Panelists:

Mr. Shigehiro Tanaka
Director-General, Multilateral Trade System Department
Ministry of Economy, Trade and Industry, Japan

Mr. Robert S. Wang
Senior Official for APEC
U.S. Department of State

Ms. Arrow Augerot
Deputy Assistant USTR for APEC and Localization Barriers to Trade
Office of the United States Trade Representative

Mr. Michael Kaplan
Director for South and Southeast Asia
U.S. Department of the Treasury

Moderator:

Mr. Matthew P. Goodman
William E Simon Chair in Political Economy
CSIS

1415 Panel Discussion: Business Perspectives on Asian Architecture

Panelists:

Ms. Sarah Thorn
Senior Director, Federal Government Relations
Wal-Mart Stores, Inc.

Ms. Pamela Passman
CEO
CREATe.org

Ms. Anku Nath
Senior Manager, International Affairs
Deere & Company

Moderator:

Mr. Scott Miller
Senior Advisor and Scholl Chair in International Business
CSIS

1515 Closing

About the Authors

Matthew P. Goodman holds the William E. Simon Chair in Political Economy at the Center for Strategic and International Studies (CSIS). The Simon Chair examines current issues in international economic policy, with a focus on the Asia-Pacific region. Previously, Goodman served as director for international economics on the National Security Council staff, working on the Group of 20 (G-20), Asia-Pacific Economic Cooperation (APEC), and other forums. Before joining the White House, he was senior adviser to the undersecretary for economic affairs at the U.S. Department of State. He has also worked at Albright Stonebridge Group, Goldman Sachs, and the U.S. Treasury Department. Goodman holds an MA from the Johns Hopkins School of Advanced International Studies and a BSc from the London School of Economics.

Scott Miller is a senior adviser and holds the William M. Scholl Chair in International Business at CSIS. From 1997 to 2012 Mr. Miller was director for global trade policy at Procter & Gamble. He also advised the U.S. government as liaison to the U.S. Trade Representative's Advisory Committee on Trade Policy and Negotiations, as well as the State Department's Advisory Committee on International Economic Policy. Mr. Miller was the founding chairman of the Department of Commerce's Industry Trade Advisory Committee (ITAC) Investment Working Group. He holds an MA from the University of Cincinnati College of Design, Architecture, Art, and Planning and a BA from Ohio Northern University.

David A. Parker is a research associate with the Simon Chair in Political Economy at CSIS, where his work centers on economic policy issues in East Asia. He holds an MA in international economic relations from American University and a BA in Japan studies from Tufts University.

Grace Hearty is the program coordinator for the Simon Chair in Political Economy at CSIS, where she manages the Chair's operations and administration. She holds a BA in geography and history from the George Washington University.

Paul Nadeau is program manager and research associate with the Scholl Chair in International Business at CSIS. He holds an MA in law and diplomacy from the Fletcher School at Tufts University and a BA from the George Washington University.

Clare Richardson-Barlow is a project manager at the National Bureau of Asian Research. Previously, she was a research associate with the Scholl Chair in International Business at CSIS. She holds an MA from Tsinghua University in Beijing and a BA from Pacific University.

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1616 Rhode Island Avenue NW | Washington DC 20036
t. (202) 887-0200 | f. (202) 775-3199 | www.csis.org

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