

# Asia–Europe Connectivity

## THE ROLE OF TRADE IN ENHANCING CONNECTIVITY THROUGH TRADE LIBERALISATION, INVESTMENTS, AND SERVICES

RAJESH AGGARWAL, QASIM CHAUDRY, AND MOHAMMAD SAEED,  
INTERNATIONAL TRADE CENTRE

**T**rade in goods and services and foreign investment play a decisive role in strengthening economic connectivity between different regions in the world, which in turn leads to prosperity and sustainable development. Various studies have shown that enhanced interregional trade and investment flows lead to sustainable growth and job creation. This was also reiterated by the leaders during the 10th Asia–Europe Meeting (ASEM) in Milan in 2014.

In recent years, ASEM members have achieved significant progress on ambitious development plans such as the European Union (EU) Infrastructure Investment Plan, the Master Plan on ASEAN Connectivity, the Belt and Road Initiative and the Asian Infrastructure Investment Bank. These have led to enhanced infrastructure connectivity between the two regions particularly in the areas of transportation, telecommunications (ICT), and energy resulting in significant short-term and long-term gains.

However, the potential for Asia–Europe connectivity goes beyond just transport and infrastructure and should also include stronger linkages between institutions to facilitate trade and investment through initiatives such as streamlining of regulatory regimes and procedures and sharing of knowledge and ideas. The synergies between ‘soft’ and ‘hard’ connectivity initiatives need to be further expanded for which the ASEM platform is strategically placed.

Additionally, it is evident that larger subregional groups within Asia and Europe (for example, Eastern Europe, Southeast Asia, China, etc.) are pursuing connectivity initiatives on their own or with other countries in the regions which can potentially be integrated into common connectivity initiatives of ASEM to benefit both regions as a whole.

### Changing Landscape of International Trade

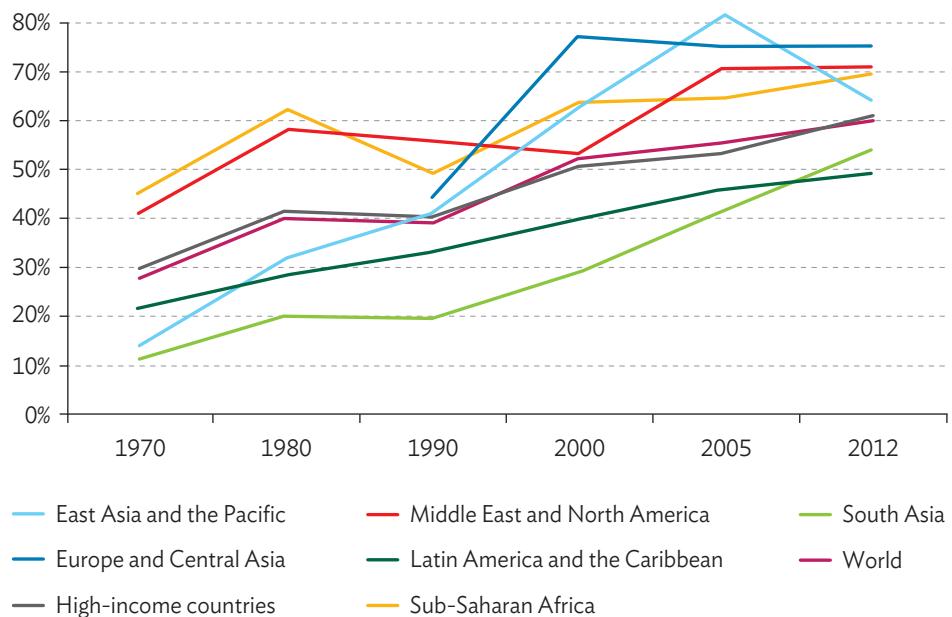
The world has witnessed dramatic growth in international trade in the past few decades. The value of world merchandise exports rose from \$2.03 trillion in 1980 to \$18.26 trillion in 2011 (WTO, 2013).

## Trade liberalisation has resulted in more open economies

Enhanced international trade can be attributed to a number of factors. Firstly, all regions in the world have become more open to trade resulting in growth in global trade to GDP ratio from 25 percent in the 1960s to 60 percent in 2012 (Figure 1). During this period, the average tariff levels have decreased significantly and continue to do so as a result of increased connectivity through trade agreements.

However, openness to trade (and investment) alone cannot ensure successful economic integration into the global economy. Equally important is the conductiveness of the business environment which depends on factors such as quality of hard and soft infrastructure, trade-friendly policies, reduction in transport, cross-border and communications costs as well as in trade barriers, among others. These will be discussed in more detail in the subsequent sections of this chapter.

**Figure 1: Evolution of How Economies Opened Up to More Trade**



Note: This graph depicts the evolution of how economies have become more open to trade since 1970. It shows the shift over time in percentage of trade to GDP, by region.

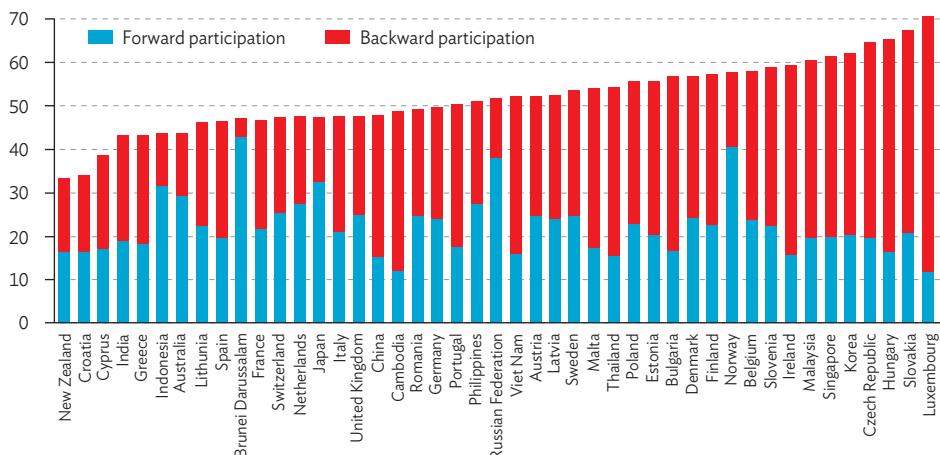
Source: World Bank, *World Development Indicators database*.

## Global value chains (GVCs) as a driver of changing international trade landscape

Technological revolution in the means of communication and containerisation, aided by the concomitant liberalisation of trade and investment, has brought about a paradigm shift in the production patterns of manufactured goods in the past few decades. The process of producing goods from raw materials to finished products is increasingly fragmented and carried out wherever the necessary skills and materials are available at competitive cost and quality. Falling transport and communications costs permit larger multinational firms to splinter their ‘production lines’ geographically (Baldwin, Graduate Institute Geneva, 2014) and design supply chains that allocate different parts of the production process to firms in different countries. Materials and components are processed or services are rendered—hence value is being added—in multiple countries that are part of the supply chain. By locating (sourcing) activities and tasks in different countries as a function of their comparative advantages, the total production costs are reduced.

As a result, GVCs have become a dominant feature of world trade and investment. The shift in the production patterns has provided development options to developing countries as they can now join existing supply chains rather than having to invest decades in building their own. Even firms in low-income countries now have the opportunity to render specific manufacturing or service to a leading firm in another country. Figure 2 depicts the magnitude of GVC participation in the export segments of different economies in ASEM including the share of backward (imported inputs used to produce exports) and forward linkages (exports of intermediaries that are processed in the importing country and then exported to a third country).

**Figure 2: Selected ASEM Members – Total GVC Participation in 2011**  
(% share in total gross exports)



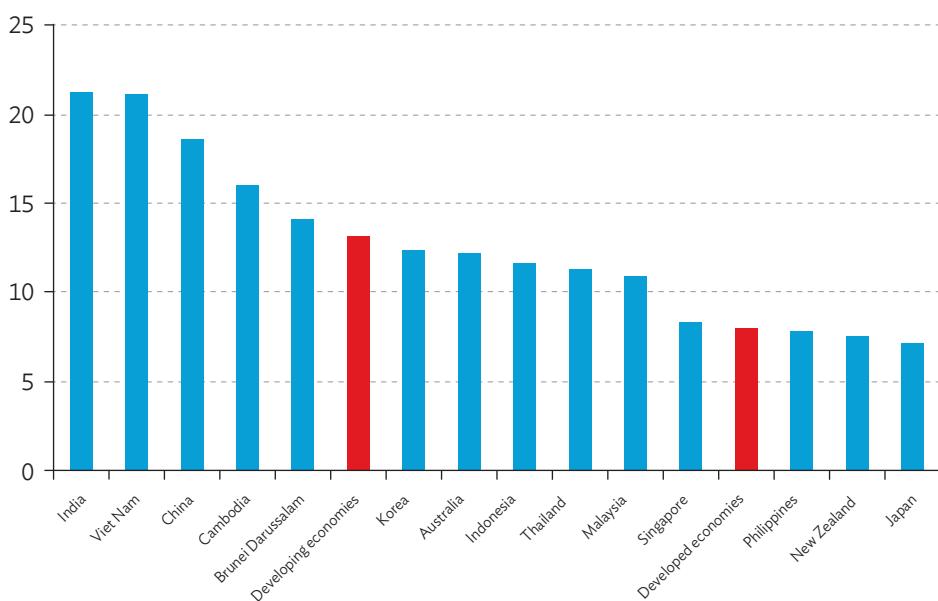
Source: WTO, ‘Trade in value-added and global value chains: statistical profiles’.

The statistics, however, vary across countries in the regions and in part, the differences reflect the economic size, level of development, geographical location, and the policies prevalent in the countries. For example, if a country imposes high tariffs or other trade barriers that make it difficult and more costly to import parts or components, it will lag behind in GVC participation as firms will not be willing to invest there.

## Participation in GVCs is significantly more in Asia than in Europe

GVC participation has grown more in Asian ASEM members than in European members from 1995 (just before ASEM was formed) to 2011 as can be seen from Figures 3 and 4. So why has Asia outperformed Europe?

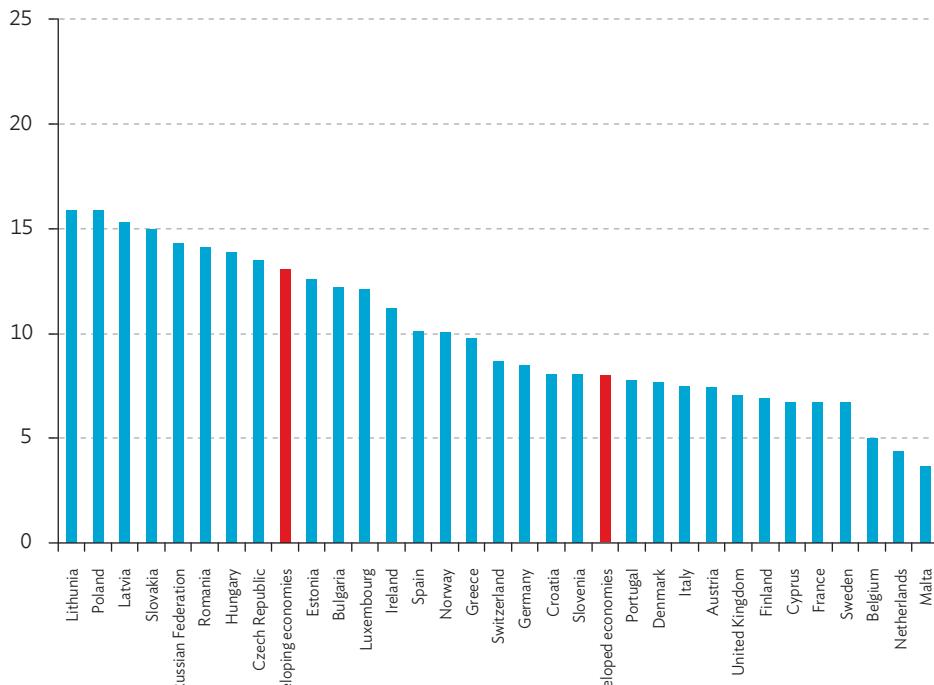
**Figure 3: Evolution of GVC Participation in Selected Asian ASEM Members**  
(annual % change)



Source: WTO, 'Trade in value-added and global value chains: statistical profiles'.

Most of the growth in world trade due to participation in GVCs is attributed to intraregional trade and not between different regions and Asia (specifically East Asia and South Asia) has seen the highest growth rate per capita among all regions in the world in the last 20 years. Similarly in Europe, Eastern Europe has grown more in the same period and this is also reflected in their growth in GVC participation (Figure 4).

**Figure 4: Evolution of GVC Participation in Selected European ASEM Members**  
(annual % change)



Source: WTO 'Trade in value-added and global value chains: statistical profiles'.

The enhanced participation of countries in GVCs implies that their firms can specialise in specific tasks in the value chains instead of the whole products or industries, which in turn could potentially improve their competitiveness in global markets. While the literature on GVC is in flux and evolving, increasing evidence suggests that GVC participation may at least be associated with higher growth.

Furthermore, interregional trade through GVCs involving Asia and Europe can potentially offer further benefits in today's fast-changing world where innovation is at the frontier and an important channel of growth. These benefits provide countries to reap dynamic gains from trade through foreign investments in both directions and technology and knowledge transfer related to production and logistics methods, which has shown to be higher across countries linked through GVCs (Piermartini and Rubinova, 2014).

## SMEs have become a major player in international trade and their importance continues to grow

The changing landscape of international trade has coincided with the rise in the relative importance of small and medium enterprises (SMEs) and the role they play in the economic development of countries of all development levels. More and more SMEs continue to tap into GVCs and are now able to access export markets. SMEs participate in GVCs both by exporting intermediate goods to buyers in a different country, and/or by supplying intermediate goods to multinational corporations (MNCs) located domestically. In either case, the contribution of SMEs is eventually incorporated into a finished product and sold in regional and global markets.

This is a positive development for SME competitiveness because companies (SMEs or otherwise) that export, or compete with exports, are generally more efficient and obtain higher levels of productivity than those that do not. As SMEs become integrated into larger international business models, they learn (international) best practices merely by association. Moreover, attracting and maintaining internationally oriented SMEs bring greater benefits to host countries, specifically in the form of employment. Collectively, SMEs are already the main source of jobs in most economies, but there is an extra employment boost associated with internationalised SMEs. Needless to say they have also greatly benefitted from the declining trade costs and strengthening transportation and telecommunication networks and technologies.

Globally SMEs make up over 95 percent of all firms, account for approximately 50 percent of value added and 60–70 percent of total employment, when both formal and informal SMEs are taken into account. In the EU, SMEs constitute 99.8 percent of all businesses, 66.9 percent of employment and 58.1 percent of value added. This translates into 88.8 million jobs and over €3.6 trillion in value added, with SME exporters contributing 34 percent of total EU exports, or €1.54 trillion. Evidence for 10 Southeast Asian countries shows that, on average, SMEs account for 98 percent of all enterprises and employ 66 percent of the labour force. These SMEs contribute approximately 38 percent of GDP and about 30 percent of total export value. In China, the world's biggest exporter, SMEs represent 41.5 percent of total exports by value, clearly underlining their importance to the Chinese economy (ADB, 2013).

Therefore, SMEs have played a vital role in the growth of global trade through trade of intermediary goods especially in Asia (representing more than 30 percent of the region's exports) and Eastern Europe. It is no surprise that they are central to the policy agenda of many countries as well as global initiatives such as the United Nations Global Goals and B20/G20 and should also be at the forefront of any future ASEM initiatives.

## Recent Trends

### **Asia and Europe have become major players and partners in the international trade landscape and this has been fuelled by the rise of Asia**

During the past few decades, Asia and Europe have emerged as powerhouses in international trade and generated a significant share of the global economic activity. The trade between Asia and Europe is immensely important and has been consistently growing. At €1371 billion at the end of 2013–2014, trade among ASEM members accounted for over 60 percent of the total global trade. In 2012, they accounted for 57.2 percent of the world GDP, 24.5 percent of which was contributed by European ASEM partners and 32.7 percent by Asian ASEM partners (Eurostat website). Efforts are under way to increase trade flows between the two regions and further integrate into each other's economies.

The rise of Asia in the last few decades has provided an opportunity to all other regions to undertake connectivity initiatives and enter into mutually beneficial agreements. Trade in Asia has grown more rapidly than any other region and has coincided with economies in Asia undergoing a transformation to adopt outward-looking development strategies and market-oriented policy reforms to embrace openness in trade policy and foreign direct investment (FDI). East Asian economies were the first to realise the benefits of these policy reforms which explains why economies of the Association of the Southeast Asian Nations (ASEAN) have outperformed their continental counterparts.

### **Intra-regional trade in both Asia and Europe has been growing significantly and at a faster rate than trade with any other region**

There has been a significant rise in intraregional and intra-industry trade in Asia (and to some extent in Eastern Europe) which is due to the geographical dispersion of production to lower-wage economies by the relatively more developed among developing economies such as China that focused on the production of high value-added components and capital goods. The creation of these dynamic regional supply chains was backed up by extensive trade liberalisation efforts which saw a dramatic increase in the free trade agreements (FTAs) in Asia (from around 50 in 2000 to over 250 in various stages of development), most of which are purely intraregional. The trend has continued as countries are increasingly addressing country-specific problems and opportunities through conclusion of free trade agreements and other types of bilateral or plurilateral economic partnerships.

Intraregional trade in the EU also continues to grow (albeit not as dramatically as emerging Asia) and is continuing to recover from the dip in 2008. Statistics suggest that trade within the region has accounted for more than 70 percent of the region's total merchandise exports on average over the last 20 years (WTO, 2015).

However, it is pertinent to mention here that Europe remains an important destination for the final goods exported from Asia even if this share (of total exports of final goods from Asia) has decreased relatively as a result of the financial crisis.

## **Development divide still exists in both regions and needs to be accounted for**

It is important to note that significant variations in trade data exist in Asia–Europe trade pattern for different countries within the blocs. This is due to vast differences in development and economic levels of countries within each region. For instance, ASEAN countries perform much better in trade with Europe than Central Asian ones, which is evident by the fact that the total trade between the EU and ASEAN is €180 billion whereas total trade between the EU and Central Asia is €35 billion (Eurostat website).

Similarly, there is a gap between different countries in Europe also when it comes to trade with Asia. More advanced economies in the EU account for majority of the exports from Asia to Europe compared to the less advanced ones (for example, Germany is the main destination in Europe for exports from Asia while most of Portugal's trade is intraregional).

## **Enhanced GVC Participation: Key Trade Policy Determinants**

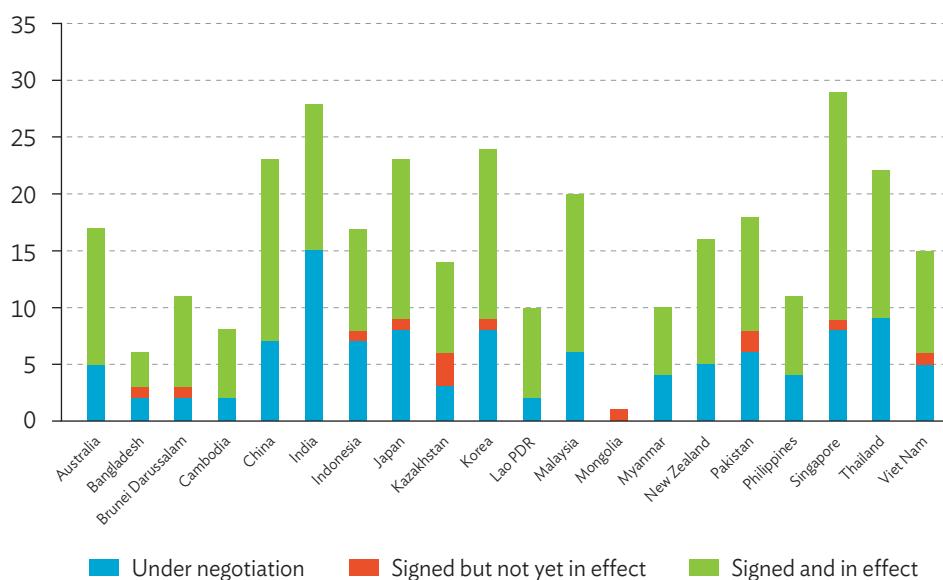
The advent and increased proliferation of GVCs in an ever more globalised and interconnected world has forced policymakers to face the reality of the changing landscape in international trade and address trade policies accordingly to ensure that their countries remain competitive in global markets. More and more, businesses require access to foreign markets as much as they require access to imports that are used as inputs to keep production costs at a minimum. In this aspect, potential trade barriers including, *inter alia*, barriers to trade in services and cross-border costs of trade in goods can hamper competitiveness of products. Therefore, trade policy needs to be shaped in such a way that it addresses and facilitates the key determinants of successful participation and integration into GVCs. The key determinants in this respect include addressing non-tariff measures (NTMs) in goods trade, liberalising trade in services, investment policies, and undertaking trade facilitation reforms.

Next we look into the existing initiatives in Asia and Europe and the corresponding challenges in each area of trade policy which, individually and collectively, play a vital role in connectivity on regional and global levels and warrant attention from ASEM Leaders, national policymakers and business associations.

## Trade liberalisation

As discussed in earlier sections, the last two decades have seen massive proliferation of FTAs in Asia which has contributed to the intraregional trade growth through GVC participation. Figure 5 shows the large number of FTAs in effect or being negotiated by ASEM Asian members which have increased exponentially in the last 15 years. ASEAN has been at the forefront and has signed FTAs with all important regional markets such as China, India, Japan, Australia, and South Korea. Recent FTAs have gone deeper to include regulations on services and investments, intellectual property protection, and competition policy. However, it is pertinent to note that given the development divide in Asia, some countries have lagged behind in connecting to the regional and global markets as they continue to use tariffs to protect their domestic industries and have not fully integrated into GVCs which magnify the costs of protectionist measures.

**Figure 5: Breakdown of FTAs for ASEM Asian Members**



Source: Statistics from ADB Asia Regional Integration Center, 2015.

Conversely, European economies have not been able to take full advantage of a rising Asia as they do not have the same autonomy in negotiating FTAs which is handled by the EU. This gives rise to different agendas among member states which could possibly explain why the EU has been slow to attain much progress on FTAs with Asia (especially when compared to other global economies such as the United States, China, etc.). The EU and Asia seem to

have abandoned the regional approach after the failed negotiation of EU–ASEAN trade deal in 2007. Instead, the EU is currently negotiating bilateral trade agreements with a number of Asian countries such as Japan, China, India, and Singapore. The outcomes of these negotiations could provide the parties with significant trade and investment opportunities, just as EU’s first FTA with an Asian country, South Korea, was considered to be a major achievement in liberalising trade to an extent never done before, in terms of lifting both tariff and non-tariff trade barriers.

Empirical evidence confirms that Europe has been slow to latch onto the global shift from multilateral trade agreements to bilateral FTAs. However, current free trade initiatives with Asia reflect their new trade strategies to increase effectiveness and transparency of trade and investment policy and to strengthen their presence in Asia and the Pacific. The European Commission asserts that these on-going deals, when completed, would increase EU GDP by 2.2 percent (€275 billion). Put in another way, this has the effect of admitting a country as big as Austria or Denmark into the EU economy. Furthermore, 2.2 million new jobs would be generated. Similar positive effects could be expected for its partners in Asia. Asia and Europe are also parties to multiple landmark deals such as the Trans-Pacific Partnership and EU–Canada Comprehensive Economic and Trade Agreement which aim to deliver new economic opportunities and eliminate bottlenecks.

A critical aspect of the trade deals between the two continents is strengthening the growth of SMEs. About 600,000 SMEs account for over 80 percent of the total number of EU goods exporting firms and for one-third of total EU exports. Hence, the European Commission recognises SMEs as an integral part of EU policy objective. In particular, increasing facilitation of SMEs globalisation is identified as important in multiple European Commission Communications over the last few years.

At the same time, challenges remain that are a threat to Asia–Europe connectivity and includes the aforementioned growth of intraregional trade in the respective regions. In addition, a new landscape of plurilateral trade agreements in Asia to which Europe is not a party. Asian countries are looking to combine FTAs and are negotiating parties of the ASEAN Economic Community, the Regional Comprehensive Economic Partnership (RCEP), and the trilateral trade pack among China, Japan, and South Korea, which can potentially transform Asia into one of the world’s largest markets. Similarly, Europe is actively pursuing deals of its own, among which are Transatlantic Trade and Investment Partnership and Trade in Services Agreement, and integration of FTAs with Asia seems to be low on the agenda.

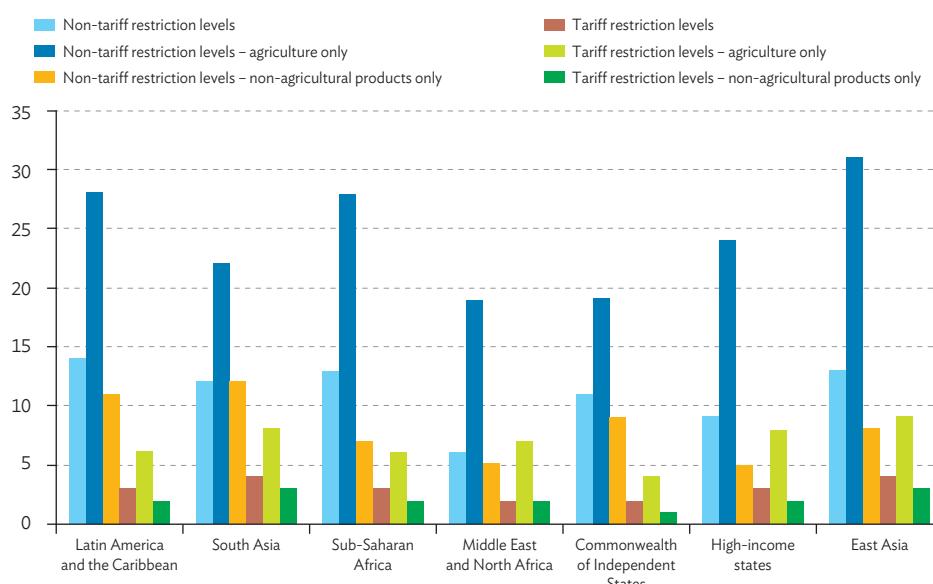
The rise of NTMs in recent decades is another challenge that continues to hamper inter-regional trade. Global trade liberalisation efforts have ensured that tariffs, quotas, and related quantitative restrictions are decreasing. However, this has given rise to NTMs as economies are now using these types of trade barriers to achieve legitimate public policy objectives

such as to protect their local industries and consumers (e.g. sanitary and phytosanitary [SPS] and technical barriers to trade [TBT] measures). These increase the compliance costs for traders and become especially burdensome in the trade of intermediate goods when they have to cross multiple borders in the production life cycle. In practice, a variety of SPS procedural obstacles to trade appear to persist. Countries should make effort to address these obstacles to enable trade to flow more smoothly and quickly.

A UNESCAP (2014) study has estimated that less than 10 percent trade costs are related to tariffs, and between 10 to 30 percent are related to natural costs, the remaining 60 to 80 percent are related to non-tariff policy measures. Statistics (Figure 6) show that protection levels and affected products vary widely across regions and generally, agriculture products face much higher trade barriers due to consumer health and safety concerns (both tariff and non-tariff). For example, NTMs are applied by EU on agriculture products for health and safety reasons and by Japan on the automobile industry for protectionist reasons.

The non-tariff trade barriers also include procedural obstacles to trade and are more prevalent in Asia than in the EU. These include inefficiencies in procedures and in cross-border trade that result in added costs for the traders. Most of these are linked to trade facilitation and will be covered in the next section.

**Figure 6: Trade Barriers, by Region and Product**



Source: World Bank, Overall trade restrictiveness indices and import demand elasticities. <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:22574446~pagePK:64214825~piPK:64214943~theSitePK:469382,00.html>

Finally, the trade liberalisation efforts between the EU and Asia should seek to address concerns related to tariff and non-tariff measures. There is a need to develop policies that enhance GVC participation, address countries' legitimate objectives and at the same time are not restrictive for traders, especially SMEs for whom high cost of compliance falls disproportionately and mostly leads to lost business opportunities.

## Trade in Services

The increasing dominance of GVCs has been accompanied by an evolving landscape for trade in services too, which further confirms the importance of identifying synergies between goods, services, and investments in designing trade policies. Broadly speaking, trade in services in GVCs comes into play in two ways—services are directly traded across borders or services form part of goods and are traded indirectly (for example, engineering or financial services that may be part of the production of industrial machinery).

Trade in services has become a major priority for developed and developing countries alike for achieving development goals through international trade, with a few key sectors figuring in more prominently than others as complementary to manufactured exports and industry. These include sectors such as information and communications technology, supply chain management, logistics services and others that are essential enablers for effective GVC participation (especially when geographically dispersed) and contribute to economic growth by improving performance of complementary industries, competitiveness of businesses, and employment.

Trade in services should also be noted for its relative resilience through the latest economic crises, demonstrated by lower volatility, lower magnitude of decline, and faster recovery. Services trade recorded negative annual growth in 2009 for the first time in two decades, but soon resumed to pre-crisis level in 2010. Such resilience encouraged many countries to enhance trade in services as a part of their post-crisis strategies.

New trade statistics reveal that domestic value added from services exports is larger than that of manufactured exports. During the last few decades, services have been rising rapidly in importance as inputs in manufactured exports; these now account for approximately one-fifth of total trade.

Europe and Asia are no exception to this global phenomenon. Extra-EU trade ranked first in both exports and imports of commercial services in 2014, accounting for 985 out of US\$3,760 billion in total world services trade (WTO International Trade Statistics, 2015). East Asia maintained the largest portion of trade in services (as well as in goods) among developing countries, at an estimate of US\$800 billion in 2013 (WTO International Trade Statistics, 2014). Despite the overall expansion, performance of each service sector depends on various economic indicators in each country in each region.

A comparison of the OECD Service Trade Restrictiveness Index (STRI) reveals that Europe is more open than Asia overall, but differences still exist among countries in each region. For instance, the Netherlands scored well below the average in all sectors to the extent that it recorded the minimum in eight sectors, while Austria scored above average in 11 of 17 sectors, after exclusion of maritime transport services for landlocked countries.

The extent to which services play a role in an economy also varies across subregions. For instance, most Southeast Asian countries have been lagging in services while the share of services in GDP in some ASEAN countries has remained the same or, in some cases, declined. Moreover, the level of trade liberalisation in services compared to that of goods is lower in Southeast Asia and East Asia than other regions.

However, it is important to note that services trade may still play an important part in an economy even if it accounts for a small portion of the GDP or gross exports. A more relevant indicator to measure the impact would be the value addition of services in the export of goods. Korea is one such case, where services account for approximately 17 percent of the gross exports which in turn accounts for 43 percent of its value added exports of goods. This indicates that Korea's export of goods relies heavily on services inputs. Similarly, over 50 percent of Dutch value added exports come from services although they only account for 16–17 percent of gross exports and imports.

Services trade and the role of services in general also play a key role in boosting the economy as a whole: for example, more than 60 percent of the current stock of global FDI is in services. Mode 3 of services trade deals with delivery through foreign affiliates, which entails FDI. This can prove to be a great source of national growth and development.

Since services themselves do not physically cross borders, services trade is not affected by tariffs but rather by domestic regulations that influence the supply of services. These may result in barriers to trade and can be in the form of horizontal regulations that affect multiple or all services sectors or sector-specific regulations.

Going forward in the context of ASEM Vision 2025, there is a need to look into various countries of the two regions individually to scope the current state of play related to market access conditions, value added by services in exports of goods and domestic regulations to determine what areas to focus on. Once this is done, synergies between different countries and services sectors can be drawn to determine initiatives that can be taken on the regional level by a platform such as ASEM. Examples of such regional initiatives include harmonisation of domestic regulations between members for high value services sectors, mutual recognition agreements, easing of trade restrictive domestic regulations that impact the essential enabling sectors of GVC participation, and others.

## Investments

Past and existing efforts in the above-mentioned areas such as trade liberalisation, trade in services, and removal of trade barriers have created conditions for enhanced investments which have facilitated cross-border movement of capital and know-how to increase global trade. The global value of FDI has risen more than sixfold between 1990 and 2012, to reach US\$22.8 trillion. The rate of FDI growth has been substantially higher than the growth in trade, which increased 3.5 times over the same period. This growth has been facilitated by some 3,000 bilateral investment agreements.

FDI plays a key role in the initial integration of countries in GVCs by facilitating knowledge (including technology) transfer as well as in the subsequent phase of moving up within the value chains to higher value products and thereby improving the quality of exports. These investments are mostly driven by large MNCs and international private sector that are always looking to invest additional resources to maximise incentives from the countries' comparative advantages. According to UNCTAD, an estimated 80 percent of global trade now occurs within international production networks of MNCs that are responsible for more than US\$1 trillion of global FDI flows annually. Given their importance to the economic development of participating countries in GVCs, MNCs have even resorted to direct negotiations with governments in the past on efficient customs processing before making decisions on FDI.

As expected, the global landscape of FDI flows has also been evolving in the same pattern as trade flows. Before 2000, developed OECD countries topped the FDI flows which have changed in the last 15 years when developing economies, primarily in Asia, started receiving the lion's share.

As European MNCs remain the main destination for Asian exports, they are also responsible for FDI inflows in Asia. As with other trade policy areas, some subregions in Asia and Europe respectively performed better than the others. FDI into ASEAN countries has risen for the third consecutive year from \$117.7 billion in 2013 to \$136.2 billion in 2014. Despite a 16 percent decline of global FDI flows in 2014, ASEAN member states have collectively received the largest FDI among developing countries. Due to robust regional economic fundamentals, cost advantages, regional integration, and on-going efforts to improve the investment environment in ASEAN, the region is now seen as a prime investment destination, attracting investments and influencing corporate strategies in the region. Investments from ASEAN member states also continue to rise, reaching \$24.4 billion in 2014 from \$19.4 billion of the previous year. With intra-ASEAN investment accounting for 18 percent of the total FDI into the region, ASEAN is now the second largest investor in its own region, manifesting greater interest from the business community to have a stronger regional presence in light of the establishment of the ASEAN Economic Community by the end of 2015 (UNCTAD and ASEAN, 2015).

A platform such as ASEM can play a key role in bringing together Trade Support Institutions and Trade and Investment Support Institutions from all member countries to develop strategies to promote and attract investments. The same platform can also be used to encourage advocacy to develop backward linkages to promote inclusiveness of all stakeholders including SMEs and to bring reforms in areas such as business environment and trade liberalisation by setting up institutional collaborations.

Moreover, investments are also needed to be channelled to introduce trade facilitation reforms. The faster, more efficient, and predictable exporting will also allow businesses to climb up the value chain into higher-margin products and ignite a positive feedback engine of growth in developing countries: as increased FDI comes into the country, local private enterprises will also invest in improving the business and trade infrastructure, and as the business and trade infrastructure improve, more FDI will follow (OECD, 2014).

## Recommendations

Connectivity through GVCs will continue to be an essential feature of trade and linkage between Asia and Europe. In this aspect, trade policy has a crucial role to play in strengthening this relationship. Notably, rules-based, predictable, and liberal trade environment coupled with ease and transparency in trade in services in the overall backdrop of investment friendly and conducive policies can lead to knowledge and expertise transfer, enhanced flows of FDI, and fostered participation of SMEs in GVCs.

Based on the analysis of connectivity in the different areas of international trade and the current global and regional landscapes, the following recommendations (in addition to the ones at the end of each section above) should feed into the ASEM Vision 2025 agenda.

### **Enhance the mandate of ASEM to transform it into a more effective institution**

ASEM is recognised as a forum for dialogue and coordination and not an institution that can dictate binding obligations. However, for it to be effective, a mechanism needs to be developed which can institutionalise the forum (possibly through linkages with and between economic unions such as the EU and ASEAN Economic Community) and enhance cooperation to strengthen connectivity and constantly review it for continuous improvement.

ASEM should develop an inclusive and sustainable approach to address infrastructure, institutional and logistics issues to augment regional connectivity and development. This can be done by developing synergies between different pillars of connectivity (physical, institutional, and people-to-people) and by ensuring that they are pursued in a collective way.

## **Consolidate trade liberalisation efforts and redesign FTAs to address all areas of trade policy**

The large proliferation of FTAs in Europe and Asia has a ‘noodle bowl’ effect which is challenging to manage and consolidate. Combining FTAs (within Asia and Europe as well as interregional) is a difficult and complex task because of the different levels of development of ASEM members in each region. For example, the EU cannot combine FTAs with Asian members to the most advanced FTA in the region (Singapore) as it would not work for less developed nations. Therefore, a more regional approach is required.

When designing and negotiating FTAs, a more coherent and comprehensive approach is required to make them more holistic and address all trade-related issues such as trade in goods (tariffs, regulations, procedures, etc.); trade in services (market access, domestic regulations, etc.); and investments. A combined trade and investment policy will have more impact on connectivity between the two regions.

Additionally, harmonisation of services regulations, standards, and procedures across the regions will play a vital role in reducing trade barriers including non-tariff and market access barriers.

## **Ensure inclusion of all stakeholder groups to engage in public–private dialogue**

The forum of ASEM should move beyond leaders and strive to bring all stakeholders (such as private sector representatives, relevant government officials, members of Trade Support Institutions and Trade and Investment Support Institutions, etc.) from different countries together to identify common issues, design solutions, and share knowledge and ideas. The role of the private sector and businesses, especially SMEs, must be acknowledged in trade policy formulation and must be included at all levels in ASEM. A business council, housed under ASEM, may be set up to bring together businesses from both regions to form common positions and engage with leaders in public–private dialogue.

Coordination among government agencies at the national, regional, and ASEM levels must be improved to set and achieve common objectives and goals in consultation with the private sector.

## **Develop innovative initiatives to further enhance connectivity between the two regions**

- Regulatory connectivity is a key to better links between Europe and Asia. It has to be in the form of an agreed framework to facilitate and enhance regulatory cooperation. This would also enhance the regulatory capacity of developing countries in ASEM.

- In the absence of any multilateral or large regional agreements on investments, ASEM should work to carve out one which would cover the existing flows of investments from Europe to Asia and provide for reverse flow as well.
- Establish cross-continental value chains in services to address and strengthen all segments of economic activity and involve less developed countries to provide developing countries with opportunities to move up the value chains.

## REFERENCES

ADB Institute (2016), Major challenges facing SMEs in Asia and solutions for mitigating them.

ASEAN (2015), *ASEAN Investment Report: Infrastructure and Investment Connectivity*. Jakarta: ASEAN.

Cernat, Lucian, Ana Norman-López, and Ana Duch T-Figueras European Commission (2014), 'Chief Economist Note: SMEs are more important than you think', *Chief Economist Note*, Issue 3, September, European Commission, [http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc\\_152792.pdf](http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152792.pdf) (accessed 15 May 2016).

European Commission (2016), 'eEurostat', <http://ec.europa.eu/eurostat>

European Commission (2016), 'Trade country profiles'.

European Commission (2016) website, 'Trade for all: New EU trade and investment strategy', <http://ec.europa.eu/trade/policy/in-focus/new-trade-strategy/> (accessed 1 June 2016).

ITC (2014), *50 years of unlocking SME competitiveness: Lessons for the future*. Geneva: ITC.

OECD (2016), 'STRI country profiles'.

OECD and World Bank (2015), 'Inclusive global value chains'.

Piermartini, Roberta and Stela Rubinova (2014), 'Knowledge spillovers through international supply chains', WTO Working Paper ERSD-2014-11, 23 July 2014, Geneva: WTO, [https://www.wto.org/english/res\\_e/reser\\_e/ersd201411\\_e.pdf](https://www.wto.org/english/res_e/reser_e/ersd201411_e.pdf)

UNCTAD (2015), *World Investment Report: Reforming International Investment Governance*. New York and Geneva: UNCTAD.

UNCTAD (2013) website, 'Global importance of services', <http://unctad.org/en/Pages/DITC/Services/Global-importance-of-services.aspx>

World Bank (2015), *East Asia and the Pacific Economic Update*. Washington, DC: World Bank.

World Bank Development Indicators database, <http://data.worldbank.org/data-catalog/world-development-indicators>

WTO (2013), *Global value chains in a changing world*. Geneva: WTO.

WTO (2013), *World Trade Report: Factors shaping the future of world trade*. Geneva: WTO. [https://www.wto.org/english/res\\_e/booksp\\_e/world\\_trade\\_report13\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/world_trade_report13_e.pdf) (accessed 5 December 2015).

WTO (2013), *World Trade Report: Factors shaping the future of world trade*.

WTO (2014), International Trade Statistics, [https://www.wto.org/english/res\\_e/statis\\_e/its2014\\_e/its14\\_toc\\_e.htm](https://www.wto.org/english/res_e/statis_e/its2014_e/its14_toc_e.htm)

WTO (2015), ‘International trade statistics and country profiles’, [https://www.wto.org/english/res\\_e/statis\\_e/its2015\\_e/its15\\_toc\\_e.htm](https://www.wto.org/english/res_e/statis_e/its2015_e/its15_toc_e.htm)

WTO website, ‘Trade in value-added and global value chains: statistical profiles’, [https://www.wto.org/english/res\\_e/statis\\_e/miwi\\_e/countryprofiles\\_e.htm](https://www.wto.org/english/res_e/statis_e/miwi_e/countryprofiles_e.htm)

Yoshino, Naoyuki and Farhad Taghizadeh-Hesary (2016), ‘Major Challenges Facing SMEs in Asia and Solutions for Mitigating Them’, *ADBI Working Papers*, No. 564, Tokyo: ADBI.