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Annex 4 - APEC Best Practices for Promoting Supporting Industry in the Asia Pacific Region

Purpose: Consideration

Submitted by: CTI Chair

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APEC Best Practices for Promoting Supporting Industry in the Asia Pacific Region

1. Objectives

For achieving a more resilient regional economy with sustainable, inclusive and innovative growth in Asia Pacific Region, it is imperative to promote innovation encourage entrepreneurship, and facilitate the participation of Micro, Small and Medium Enterprises (MSMEs) and local enterprises into the regional value chains. In particular, supporting industries, which are largely MSMEs, play important roles in value chains with their sophisticated and modernized technologies. In other words, supporting industries are considered essential “infrastructure”, and therefore should be one of the policy targets in order for all APEC economies to boost their economic growth.

Continuous change in production patterns and advancements of technology has posed both opportunities and challenges to supporting industries. On one hand, they have opened new possibilities. On the other hand, they have made it imperative that existing supporting industry firms adapt or be forced out of the market. In a globalized world, the role of supporting industry is even more vital considering that improvements in technology and logistics have made it more cost-effective for firms to be focusing only on activities that they have comparative advantage in and outsource the rest. Other reasons for outsourcing include: (i) requirements by laws and regulations; (ii) lack of expertise or specialization in-house; (iii) non-feasibility to supply in-house; (iv) economies of scale; and (v) network economies. These developments have essentially made supporting industry an important contributor to economic growth in all economies, some more so than others. To ensure that supporting industries in APEC remains competitive and relevant, policies in individual economies should be responsive to these changes.

Against this backdrop, APEC is expected to contribute collectively to promote supporting industries in the region, by sharing policy experiences, discussing possible good policies to nurture competitive, high-skilled and modernized supporting industries, and improving the quality of policies in the Asia Pacific region.

Annex B of the APEC Honolulu Declaration in 2011, Enhancing Small and Medium-Sized Enterprises Participation in Global Production Chains, indicates that supporting industries may be defined as suppliers of inputs and/or services to be incorporated into the production chain of other enterprises which participate in international trade”.

In line with the objectives, APEC has collected policy experiences of three APEC economies (Australia, Mexico and Viet Nam) in promoting competitive, highly-skilled and modern supporting industries. These case studies have been selected to take into consideration geographical distribution in the

APEC region and the level of development of member economies (See Annex A).

APEC PSU's synthesis report, which brings together the policy experience of three APEC economies mentioned above (See Annex B) defines "'supporting industry', in its broadest sense, as manufactures and suppliers of raw materials, capital goods and intermediate goods as well as production services to user firms". At the same time, the report noted that 'supporting industry' is not a universal term used globally or in the context of APEC, by all member economies. The report also found that "there are variations in the motivations behind an economy's interests in developing or enhancing their supporting industry which, to a certain extent, can be associated to the level of development of the analyzed economies". Taking into consideration the above mentioned general understandings, it is necessary that policies for development of supporting industries consider the specific background and needs of each economy.

Japan and Viet Nam also organized the 'Policy Seminar on Supporting Industries' to share good practices for promoting supporting industries in this region. In this seminar, the representatives from Japan, Viet Nam, Chinese Taipei, Korea, and Malaysia introduced various types of policies for promoting supporting industries, as well as the outline of three case studies (See Annex C).'

This APEC Best Practices for Promoting Supporting Industry in the Asia Pacific Region aims to (1) share good practices and provide a source of reference on various aspects that economies wish to consider when developing their policies to promote supporting industries, and (2) assist closer cooperation among APEC economies. Building on this Best Practices, APEC economies are encouraged to take further initiatives and strengthen cooperation among APEC economies in relevant APEC forums in particular in CTI and SME Working Group for further improvement of the quality of supporting industry promotion policies including through information sharing and capacity building activities.

2. Background

The reference of "Supporting industries" in APEC is mentioned as one area for cooperation to enhance SME's participation in global production chains, which is in the Annex B of the APEC Honolulu Declaration in 2011, Enhancing Small and Medium-Sized Enterprises Participation in Global Production Chains. Specifically, point c of the Annex on "Enhancing SMEs' understanding of how to become reliable supporting industries and to establish business ties with other supporting industries, final goods, suppliers, and exporting industries." is expressed to take advantage of cooperation in the area of supporting industries. Furthermore, the Boracay Action Agenda to Globalize MSMEs was agreed in APEC Ministers Responsible for Trade in 2015, which was held at Boracay, Philippines. In the Agenda, it is mentioned that "APEC economies recognized that in making growth equitable and

inclusive, the goal of APEC has centered on the development of the region's micro, small and medium enterprises (MSMEs). Hence, an important component of APEC's efforts is to bolster their ability to take advantage of cross-border business. The emergence of global supply chains and the proliferation of preferential trade agreements have created opportunities for SMEs to participate in trade, lend support to APEC's efforts to increase trade flows in the region, and strengthen economic integration."

As a way to achieve the Agenda, Japan and Viet Nam jointly proposed APEC Supporting Industry Initiative in 2016. This Best Practices is developed in accordance with the APEC Ministers' instruction in the AMM Joint Statement in 2016.

3. Key elements for promoting supporting industries

While noting that the richness and wide variation of insights obtained from case studies make it challenging to generalize policy recommendation which are applicable across all APEC economies, APEC PSU's synthesis report identifies several common key takeaways. It is encouraged that economies take into consideration these takeaways when developing the policies to promote supporting industries

Exploring comprehensive range of policies – Supporting industry firms face many different challenges in integrating into value chains, and a single firm is likely to face multiple challenges simultaneously. The range of challenges makes it imperative that policymakers explore various policy options available to firms.

Balancing sectoral nuances with flexibility – Different sectors exhibit distinctive characteristics in terms of their value chains, evolving pace of industrial trends, sophistication of technology, and intensity of capital requirements among others. Thus, the requirements and needs of sectors vary and one-size-fits-all approach may not work.

Engaging with multiple stakeholders – Different stakeholders bring diverse perspectives to the table and can contribute at various stages of the process of supporting industry development. The involvement of multiple stakeholders are therefore more likely to lead to better policies as they have incorporated the collective wisdom of broader group.

Timely policy improvements (in terms of content, awareness, implementation and monitoring) – Content that may have been appropriate at the time of formulation may become less useful over time. Awareness among potential beneficiaries is important to achieve the intended objectives of the policies. Implementation is critical as it operationalizes policies and enables access. Monitoring and evaluation lies at the crux as they provide the basis for policy improvement process.

Considering SMEs' inherent challenges – Despite the notable contributions of SMEs across many measures such as number of total firms operating in APEC region and source of employment, the extent of their participation in value chains remains relatively low. If the targeted beneficiaries of supporting industry policies include SMEs, then it is critical that these policies and their accompanying institutional structure take SMEs' inherent challenges into account.

Balancing economy-wide and local priorities – The challenges faced at national and local level may be different, and such differences may lead to variations in how policies are being operationalized. Policymakers should attempt to balance national and local priorities so as to overcome or minimize issues such as lower than expected awareness and access to policies.

Enhancing general business environment – Policies that lead to a conducive business environment, although not specifically targeting supporting industries, is critical for the development of firms in supporting industries.

Besides noting these horizontal takeaways, this Best Practices also intend to provide a source of reference on various aspects that economies wish to consider when developing their policies to promote supporting industries.

3.1 Supply side policies

3.1.1 R&D and technological development

R&D policies are essential for developing supporting industries because they can facilitate firms to undertake activities which could potentially allow them to move towards producing higher value goods, rather than just relying solely on low labor cost as its major source of competitiveness. Indeed, some of the perennial concerns of middle income economies include the danger of being squeezed out by competing low-cost manufacturers from other economies, while not being able to keep up with their high income counterparts. Boosting R&D among firms, including those in supporting industry is therefore one way for these economies to build on their comparative advantage. One way to assist supporting industries who are part of a bigger supply chain is that R&D be supported by larger companies who utilize their output. Thus, innovation of the large company was done by helping supporting industries innovate. In a similar vein, high income economies are required to constantly innovate as well, in order to remain ahead of the curve. However, R&D tends to be highly risky and costly, as there is no certainty on the quality of results produced. Government support is thus crucial for such activities to occur, especially for small supporting industry firms who lack the resources to do so.

3.1.2 Human resource development and capacity building firms

Human resource development can serve to boost the capability of both firm owners and their employees and therefore, potentially allow supporting industry firms to enhance their competitiveness as well as undertake more complex activities. This is particularly so for upper-middle and high income economies that is no longer able to compete on labor costs. Lower-middle income economies can also benefit from human resource development which complements its relatively low labor costs. Policies for human resource development can span a wide range, from general training such as improving existing business models through the use of consultancies, fostering collaboration with multi-national corporations, governments and academia to more targeted skills training which improves the technical skills of employees and leads to attainment of certification by firms. The myriad of policy measures means that economies have the options to tailor a solution which is more specific to their situation. It is imperative that 'skills development' is not pursued indiscriminately, but rather on the needs of each economy.

3.1.3 Cluster development

Clustering programs are essentially those that link entities such as suppliers, research institutions, final assemblers and other relevant actors with similar or complementary knowledge and interests together. Advantages of clusters include sharing common infrastructure and minimizing logistics costs, therefore reducing the need for firms to individually invest in them. Clustering could also potentially increase demand from user firms located in the same area. Technological and knowledge spillovers from research institutes and other firms in the cluster could additionally benefit supporting industry firms. Clustering programs, by their nature, inevitably tend to overlap with the objectives of other policies such as facilitating R&D activities, enhancing knowledge transfer, and linking supporting industry firms to user firms.

3.2 Demand side policies

3.2.1 Business matching

Business matching activities serve to link firms to potential customers which they otherwise would have missed. Business matching could be carried out by both governments as well as non-governmental organizations. While the case studies suggest that firms have benefitted from business matching activity conducted by the government, where foreign firms are linked to local suppliers, there also exists demand side programs that encourage supporting industry firms to expand to international markets.

3.2.2 Regulations and procurement policies

Demand for supporting industry could also be created by giving priority to SMEs when it comes to government procurement and through regulations.

3.3 General business environment

General business policies aim to create a conducive for macro-environment for all businesses. A stable and open investment regime not only benefits supporting industry firms, but also attracts MNCs that bring with them potential knowledge spillovers and other resources. Examples include liberalizing investments and ensuring macroeconomic stability, as well as reducing administrative burdens. Furthermore, liberalizing investments is a common measure adopted by many economies to attract foreign direct investment (FDI). Such policies are beneficial to the development of supporting industry as the resulting increase in FDI firms may increase demand, as well as provide opportunities for local supporting industries to learn from these firms. Facilitation of business registration and ease of obtaining credit, for instance, make it easier to start a business. State of the infrastructure affects the overall business operation. Network of free trade agreements (FTAs), to a certain extent, affect the market size that firms' products are able to access. For supporting industries to fully utilize FTAs specific and clear information sessions/programs on the economies' current FTA engagements should be outlined by the government. Discussions on market opportunities, tariff reductions, rules of origin and customs procedures, among others should be outlined clearly.

These policies may not be specific to supporting industries, but nonetheless are essential for their development.

ANNEXES (For references)

Annex A

Supporting Industry Promotion Policies in APEC - Case Study on Australia - 2017/SOM2/CTI/024b

Supporting Industry Promotion Policies in APEC - Case Study on Mexico - 2017/SOM2/CTI/024c

Supporting Industry Promotion Policies in APEC - Case Study on Viet Nam - 2017/SOM2/CTI/024d

Annex B

Supporting Industry Promotion Policies in APEC - Synthesis Report - 2017/SOM2/CTI/024a

Annex C

Summary Report for Policy Seminar on Supporting Industries - 2017/SOM2/CTI/025