New trends in international trade, emerging business models, and the needs of small and medium-sized businesses in preparing the Framework of Standards to Secure and Facilitate Global Trade

1. Background

1. The WCO Council Sessions in June 2004 adopted a Resolution on global security and facilitation measures concerning the international supply chain, by which a High Level Strategic Group (HLSG) was established to prepare the Framework of Standards to Secure and Facilitate Global Trade (hereinafter “Framework”).

2. Following the subsequent HLSG work, the 52nd Session of the WCO Policy Commission in December 2004 adopted a Resolution on the work of the HLSG (hereinafter “2004 PC Resolution”), by which the WCO Secretariat is mandated to take up a number of tasks to support the HLSG in preparing the Framework. Among those, this paper aims to carry out three closely-related tasks; namely,
   • identify new trends in international trade;
   • conduct further research into new business models that are emerging; and
   • recognize and understand the needs of small and medium-sized businesses.

3. In the following, each section covers each item in order. The second section serves as a background and presents a picture of world trade and its development since 1995 by region and selected country. The third and fourth sections relate to new trends in international trade and emerging business models, respectively. The fifth section deals with the needs of small and medium-sized businesses or small and medium-sized enterprises (SMEs). Then, the sixth section summarizes the findings of this paper.

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1 This paper mainly focuses on trade in goods. The trade in services does not come within its scope.
2. World Trade by Regions

Table 1

World merchandise trade by region and selected country, 2004
(Billion dollars and percentage)

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th>Imports</th>
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<tbody>
<tr>
<td></td>
<td>Value 2004</td>
<td>Annual percentage change</td>
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<td>World</td>
<td>8880 5 -4 5 17 21</td>
<td>9215 5 -4 4 16 21</td>
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<tr>
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<td>2010 11 -6 2 7 16</td>
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<tr>
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<td>1526 10 -6 2 8 17</td>
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<tr>
<td>Canada</td>
<td>322 8 -6 -3 8 18</td>
<td>276 8 -7 0 8 13</td>
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<tr>
<td>Mexico</td>
<td>189 16 -5 1 3 14</td>
<td>206 19 -4 0 1 16</td>
</tr>
<tr>
<td>South and Central America</td>
<td>272 5 -3 0 13 28</td>
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<tr>
<td>Brazil</td>
<td>96 3 6 4 21 32</td>
<td>66 2 0 -15 2 30</td>
</tr>
<tr>
<td>Other South and Central America</td>
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<td>4133 4 -2 5 20 20</td>
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<td>3708 2 1 7 19 19</td>
<td>3784 4 -1 5 20 19</td>
</tr>
<tr>
<td>Germany</td>
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<td>717 1 -2 2 23 19</td>
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<td>France</td>
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<td>United Kingdom</td>
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<td>Africa</td>
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<td>55 -1 -5 4 40 34</td>
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<td>Africaless South Africa</td>
<td>183 7 -7 3 23 32</td>
<td>152 1 6 0 16 22</td>
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<td>Oil exporters (b)</td>
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<tr>
<td>Non oil exporters</td>
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<td>2214 3 -7 6 19 27</td>
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<td>Japan</td>
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<tr>
<td>China</td>
<td>593 11 7 22 35 35</td>
<td>561 11 8 21 40 36</td>
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<tr>
<td>Four East Asian traders (c)</td>
<td>637 5 -14 5 15 26</td>
<td>586 2 -16 3 13 28</td>
</tr>
<tr>
<td>India</td>
<td>73 7 2 14 16 27</td>
<td>95 8 -2 12 26 34</td>
</tr>
</tbody>
</table>

Memorandum items:

MERCOsUR (4) 135 4 4 1 19 28 94 2 -6 -26 10 37
ASEAN (10) 550 6 -10 5 12 20 491 1 -8 4 10 26
EU (25) extra-trade 1203 - 1 6 17 20 1279 - -4 1 19 20
EU (15) 3447 2 0 6 19 18 3485 3 -2 4 20 18
EU (new members, 10) 260 8 11 14 29 32 299 9 6 11 26 28
Developing economies 2780 8 -7 7 18 26 2523 5 -4 4 16 27
Developing Asia 1712 7 -7 10 20 27 1629 4 -7 9 21 30

(a) Includes the Caribbean.
(b) Algeria, Angola, Congo, Equatorial Guinea, Gabon, Libya, Nigeria, Sudan.
(c) Chinese Taipei, Hong Kong China, Rep. of Korea, and Singapore.

Source: WTO.
3. **New trends in international trade**

4. International trade is increasingly recognized as a vital engine for economic development (World Bank, 2005a; UNCTAD, 2004a). In 2004, the value of world merchandise trade rose by nearly 21%, the highest growth rate in 25 years (WTO, 2005a), amounting to nearly USD 8.9 trillion. Taking account of dollar price changes, real world merchandise trade expanded by 9% in 2004, almost doubling from 5% in 2003. It continues to grow more rapidly than global Gross Domestic Products (GDP). For example, world trade grew at nearly 6% on average in 1994-2004, while global GDP at market exchange rates grew less than 3% in the same period. In the meantime, a number of new trends in international trade have been observed over recent years. Those mentioned below are among such trends which, in particular, are relevant when preparing the Framework.

5. **Trade in agricultural and manufactured goods**

5. Manufactured goods, excluding mining products, recorded above average growth in world merchandise trade during the past two decades (WTO, 2004a; 2005b). As a result, they accounted for around three-quarters of world merchandise trade in 2003. By contrast, the share of agricultural goods trade remained at around 9% in the three preceding years, which represented approximately 2% below the average level in the 1990s. One of the notable trends is that processed agricultural goods have become more important within trade in agricultural goods over the past decade. They accounted for 48% of global trade in agricultural goods in 2001-2, rising from 42% in 1990-1. This upward trend can be observed across countries and agricultural product groups throughout the 1990-2002 period.

6. **Trade between partners of Regional Trade Agreements (RTAs)**

6. A surge in trade between RTA partners was achieved mainly by a recent proliferation of RTAs. According to a recent WTO report (2004b), some 220 RTAs were estimated operational as of October 2004, of which 150 had been notified to the GATT/WTO. Nearly all WTO Members belong to at least one RTA, and each belongs to six RTAs on average (World Bank, 2005b). The number of RTAs is likely to continue to increase in coming years, considering the number of RTAs under negotiation. Consequently, it was estimated that the share of trade between RTA partners of world merchandise trade will grow to 55% by 2005 if all expected RTAs are concluded, rising from 43% at present (OECD, 2002a).

7. **Developing countries’ trade**

7. In 2004, the share of developing countries in world merchandise trade stood at 31%, having increased from about 20% in the mid-1980s (WTO, 2005a; UNCTAD, 2004a). This is the highest level since 1950. It is observed that developing countries are increasingly becoming an important destination for the exports of developed countries. Among those, in particular, some problems have been recognized in identifying tariff classification and assessing the Customs value of second-hand goods such as used cars, computer equipment, machinery and clothing. Also, developing countries contributed more to the 2003 growth of world merchandise trade than developed countries. It was estimated that nearly four-fifths of the real growth in 2003 was attributable to developing countries, including transition economies (UNCTAD, 2004a).

8. This trend requires caution, given that many developing countries, including African countries, Less Developed Countries (LDCs) and Small Island Developing States (SIDS) remain relatively marginalized from international trade (UNCTAD, 2005). However, it is observed that new efforts are being made in order to reinvigorate their regional liberalization programmes and take initiatives aimed at

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2 This is best illustrated by the fact that the WTO MFN tariff rates of the EU are fully applicable at present to only nine trading partners; namely, Australia, Canada, Chinese Taipei, Hong Kong, China, Japan, Korea, New Zealand, Singapore and the United States (WTO, 2004b).

3 Customs value is defined as “value declared for Customs purposes of those goods in a consignment which are subject to the same Customs procedure, and have the same tariff/statistical heading, country and duty regime” in the WCO Data Model.
deeper integration into global trade. For example, the New Partnership for Africa’s Development (NEPAD) in African counties was initiated in 2001. One of its primary objectives is to “halt the marginalization of Africa in the global process and enhance its full and beneficial integration into the global economy” (NEPAD, 2004).

South-South trade

9. Merchandise trade between developing countries, i.e. South-South trade, has significantly increased at an annual average rate of 11% during the past decade, accounting for nearly 13% of world merchandise trade in 2000 (UNCTAD, 2005). Around 40% of exports from developing countries were destined for other developing countries. Intra-regional trade, in particular through RTAs, played a central role in the rise of South-South trade. Also, inter-regional trade showed signs of growth, albeit on a smaller basis. In addition, intra-Asia trade took a dominant position in this trend, accounting for around 80% of the total South-South trade in 2000, but strong growth in intra-regional trade in Africa and Latin America was also observed.

Containerized cargo

10. There are a number of freight containers in use within different modes, for example, Unit Load Devices (ULDs) for aviation, Swap Bodies for road-rail carriage in Europe, and various types of maritime containers (e.g. dry and refrigerated containers) for seaborne shipping (OECD, 2003a). Among those, maritime containers are the most numerous container types involved in international trade. They are also used for inter-modal transportation, in which they are carried by maritime, inland waterway, road, and rail operators.

11. It was estimated that that over 6 billion tons of goods were traded by sea in 2003 (UNCTAD, 2004c). This accounts for over 80% of world trade by weight (OECD, 2003a). With 36% for tanker cargo (i.e. crude oil and oil products) and 24% for bulk cargo (e.g. steel, iron ore and coal), non-bulk cargo accounted for 40% by weight of the total seaborne cargo, most of which was carried in maritime containers (UNCTAD, 2004c). It was also estimated that there were 10.8 million maritime containers in circulation worldwide in mid-2003 (World Shipping Council, 2003).

Air Cargo; Express cargo

12. It is reported that world air cargo accounts at present for a small portion of world merchandise trade by weight, but a significant portion by value. World air cargo traffic has rapidly grown at a rate of over 10% during the past decade, and it is expected to continue to grow rapidly in coming years. For example, air cargo traffic has doubled over the past decade as measured in Revenue Tonne-Kilometres (RTKs: weight multiplied by distance for charged cargo). Within air cargo, the share of express cargo has also grown rapidly from 4.1% in 1992 to nearly 11% in 2003 in terms of RTKs (Boeing, 2004).

13. This important growth in express traffic can be attributed to several factors: globalization and associated Just-In-Time production and distribution systems; increased trade in high-value low-weight products; and the provision of a service that assists SMEs to compete effectively in an increasingly global market.

Global production network

14. Global production specialization has advanced, in particular in manufactured goods (World Bank, 2005b). Firstly, the share of manufactured goods within world merchandise trade has grown significantly throughout the world. Secondly, the share of parts and components exports of total merchandise exports has greatly increased in all six regions of the world, for example from 6% in 1980 to 15% in 2002 in the East Asia region (Figure 1). Thirdly, exported goods contain a significant portion of imported intermediate inputs. In the “international segmentation of production”, intermediate inputs are exported for more processed intermediate inputs, which are then exported to the next stage in production.
One of the indicators to measure import content of exports is the index of vertical specialization\(^4\). It shows a significant import content of exports in all six regions, for example, over 45% in the East Asia region in 2001 (Figure 2).

Intra-firm trade

15. Intra-firm trade, i.e. trade within the same company and/or its affiliates, reportedly accounts for around one-third of world merchandise trade, although aggregate data are only available for a few countries (OECD, 2002b). In the case of the US, for example, it accounted for 36.2% of exports and 39.4% of imports in 1999, having remained stable over the 1990s. In Japan, on the other hand, it accounted for 30.8% of exports and 23.6% of imports in 1999, which have significantly increased over the same period.

16. There was some evidence that much intra-firm trade between high-income countries was of finished goods destined for affiliates primarily involved in marketing and distribution. Even when affiliates needed further manufacturing, it was most likely that finished goods were destined for local markets. For example, around 95% of the 1999 sales by Japanese affiliates in North America and Europe happened in the same region. By contrast, intra-firm trade between high and middle-income countries was directly related to the internationalization of production (see above). The affiliates in the middle-income countries were mostly instructed to manufacture goods destined for other markets, including the country of the parent company.

E-commerce

17. Electronic commerce (e-commerce, described as “doing business electronically”) has become a dominant factor in international trade and business, although traditional methods of trade and business continue to be utilized widely. For example, the use of Information and Communication Technology (ICT) such as Internet communication has made cross-border activities easier and more practical (OECD, 2002c). It can reduce business costs in seeking potential foreign business partners, as well as improve a firm’s visibility in global marketing services, in particular for SMEs. In addition, it allows sellers to reach potential buyers for their products beyond their national borders. In other words, it enables firms to take more opportunities to expand their business in global markets. As a result, trade patterns are changing, for example, smaller shipments are increasing, and different goods are exported to and imported from more countries.

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\(^4\) A vertical specialization index measures the share of the value added of an export accounted for by imported intermediate input, either directly as imported inputs in the exporting sector or indirectly through the use of imported inputs in the domestic production of intermediate goods used by the exporting sector (World Bank, 2005b).
18. However, the so-called digital divide - a technology gap in terms of ICT infrastructure including Internet usage between developed and developing countries - is often raised. Various international and national efforts to combat the digital divide are being made. In addition, it is pointed out that the latest technology, such as wireless communication technology, may offer a reasonable solution for developing countries to quickly bridge the gap. It is also worth noting that the digital divide looks different when it is viewed from different angles: Public Services, Businesses or SMEs use of ICT internally and externally, and general access to Internet by citizens.

4. Emerging business model

19. Business models in international trade may vary from industry to industry and company to company involved in the international movement of cargo. However, there are general observations on several emerging business models in the supply chain. Brief research into some of them, which is relevant in preparing the Framework, is provided below.

**Just-in-time system**

20. The just-in-time system of goods delivery is widely accepted in international trade, in particular in the context of manufactured goods. It requires inventory to reach a production place precisely when it is needed. Thus, a supply chain is designed to reduce problems in the flow of materials, components, and finished goods across the parties involved in the international movement of cargo. For example, it was estimated that large companies in the United States on average reduced inventory from 1.57 months in the early 1990’s to 1.36 months in 2001. Then, it was estimated that over USD 100 billion was saved by the logistics efforts alone in the United States during the past decade (OECD, 2003a).

21. In order for the supply chain to function, all the parties concerned need high performance in terms of punctuality, rapidity and reliability in addition to the traditional criteria of price and operating time. Also, each link of the chain needs to be synchronized, otherwise there would be little gain.

**Supply chain security**

22. The loss of cargo shipments through theft and misrouting used to be a main security element in the supply chain. In the light of increasing threats of terrorism, however, it has emerged that the mantra of the international supply chain “getting the right product to the right place at the right time” has been modified by adding “without compromising the national security” (Waduge, 2003). The whole security level of a supply chain is heavily affected by the level of security in all the parties concerned (Dulbecco and Laporte, 2003). In other words, any security effort might be in vain if a party in the supply chain fails to achieve a minimum level of security.

**Just-in-case system**

23. Considering recent natural, political or technological disruptions to the international supply chain, the system has moved away slightly from reliance on “just-in-time” delivery to the “just-in-case” system, in which a supply chain has a certain degree of flexibility with a sound contingency plan (Waduge, 2003; Brown 2003). There is a need to consider just-in-case suppliers, vendors, or logistics as well as just-in-case inventory. It is increasingly recognized that it is too dangerous to rely heavily on a single source or logistics. A back-up system may be needed to mitigate uncertainty. As the just-in-case system may raise costs, it may be necessary to consider the balance between the level of security and extra costs in the supply chain.

**Outsourcing to local parties**

24. It is observed that many large companies have outsourced their production and service business to local companies. This is partly because they increasingly recognize the benefits of exploiting local companies’ in-depth knowledge of local markets and Customs. In the logistics area, companies specialized in logistics activities, called third party logistics (3PL), play an important role in the international supply

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chain. For example, it is estimated that around 70% of the logistics expenditure in North America and Western Europe will be directed to 3PL outsourcing by 2007.

**Internationalization of SMEs**

25. SMEs increasingly play an important role in emerging business models in the international supply chain. As large companies pursue production specialization as well as seek external complementary service resources, SMEs may gain growing business opportunities to be integrated into the global economy. There are many ways of internationalizing SMEs, for example by forming strategic alliances with trading companies (Box 1), mergers and acquisitions (M&As), and inter-firm networking (OECD, 2004). ICT such as Internet is also one of the driving elements in the internationalization of SMEs.

26. At present, a number of SMEs have already participated in international trade (OECD, 2004). In the EU, for example, around 40% of over 4 million firms that exported goods in 2001-2 were SMEs. In the United States, SMEs having fewer than 20 employees constituted around two-thirds of exporting firms in 1999. In Australia, nearly 70% of exporting firms and over 60% of importing firms were SMEs in 2001.

**Box 1: A successful case of SME export through alliance with a trading company**

*Oo-oka cooperation* (Japan) is a small manufacturing company which is specialized in gears for automobile manual transmissions. While operating two factories in Japan, the company has no overseas sales force. The company exports through a long-term sales/marketing alliance with *Kanematsu*, a Japanese trading company trading in more than 40 countries. Thanks to the high quality of the products (*i.e.* gear), the alliance has won supply contracts with major automobile producers, including General Motors (US), Daimler Chrysler and Volkswagen (both Germany), and Peugeot Citroen Automobiles SA (France). The two allied companies have shared goal of USD 40 million equivalent world-wide sales by 2005.

Source: OECD (2002c)

5. The needs of SMEs

27. It is recognized that SMEs are a vital source of job creation, export and economic development (OECD, 2004). In many countries, SMEs constitute over 95% of market participants, and account for more than a half of employment in the national economy as well as the GDP. SMEs are relatively less well-resourced than large companies, and there are many barriers that deter SMEs from accessing global markets, in particular intellectual property rights. Although certain SMEs actively participate in international trade, SMEs remain under represented in the international economy as a whole. For example, it is estimated that SMEs contribute to only around 30% of global exports by value, which has not changed much in the last decade (OECD, 2004; APEC, 2004).

28. It seems apparent that the primary need of SMEs is that the Framework should be implemented in a way not to distort effects on SMEs, but rather to enable them to take this opportunity to be further integrated into the global economy. On this point, however, it should be kept in mind that a certain sector of parties involved in the international movement of cargo are heavily represented by SMEs, and the needs may vary from sector to sector. The following are observed among the specific needs of SMEs.

**Transparency and predictability**

29. One of the needs of SMEs is that the Framework should be implemented in a transparent and predictable manner in order to provide a level playing field for both SMEs and large companies. Obligations, requirements, conditions and other elements relating to the security procedures in the WCO Members implementing the Framework (hereinafter “implementing Members”) should be clearly defined

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in national laws and regulations. Easy access and understanding of the procedures is another important element.

Capacity building

30. SMEs need adequate support, training and guidance to build their capacity for security requirements in the implementing Members. In general, SMEs have less financial resources. The security measures in place may impose additional investment on SMEs. In addition, they may need to pay extra border security costs that may be disproportionately higher than larger companies. In this regard, the implementing Members should provide SMEs with such adequate support, training and guidance so that they might more readily meet security expectations. In addition, the WCO and the Members should play an important role to support the implementing Members who scarcely deliver such support, training and guidance.

Support for SMEs to be certified as Authorized Economic Operators (AEOs)

31. SMEs need tangible benefits in return for being certified as AEOs by meeting a set of minimum security standards in the Framework. Since the AEO arrangement is of a co-operative and voluntary nature, they may simply decide not to seek AEO status, taking its costs and benefits into consideration. The AEO arrangement is one of the key elements for successful implementation of the Framework. As such, tangible benefits may encourage a number of SMEs to participate in the AEO arrangement.

32. Also, special support and consideration may be needed for SMEs in terms of AEO certification, so as not to impose disproportionately unnecessary and prohibitive burdens on SMEs in comparison with larger companies. One of the main concerns of SMEs is that they may have difficulties meeting the criteria to be certified as AEOs. Without prejudice of certification criteria determined by a national Customs administration, for example, it seems more difficult for trader-SMEs with no or a few import/export records to meet criteria such as minimum frequency of import/export transactions during a certain period to ensure an “appropriate record of Customs compliance”. Such trader-SMEs may simply decide not to seek being certified as AEOs, to stop international transactions, or to circumvent international transactions through large AEO trading companies. In the last case, in particular, one may need to watch that the AEO trading companies do not impose excessive burdens on the second or deeper-tiered subcontracting SMEs, because they are not directly certified by a national Customs administration but subject to verification by the AEO partners.

33. In addition, SMEs with few human resources may face difficulties with the self-assessment and self-policing process prescribed in the AEO arrangement. It might be the case that SMEs encounter fewer burdens for a certain type of security measure, such as background checks on employees, because there are fewer employees in SMEs than large companies. In any case, the implementing Members may need to consider allowing companies, including SMEs, to outsource those security functions to third parties with expertise in this area. On the other hand, a certain type of mutual recognition of AEO status may be helpful, in particular for less-resourced SMEs. If the AEO status that is certified by a national Customs administration is recognized by other Customs administrations and partner AEOs, they will be able to avoid multiple and duplicated certification processes by different Customs administrations and verification requests by a number of partner AEOs.

34. Finally, regular communication between SMEs and a national Customs administration may be helpful for Customs to recognize and understand the needs of SMEs in terms of the AEO arrangement, as well as for SMEs to understand AEO requirements. Furthermore, in order to figure out how effectively the AEO arrangement is utilized by SMEs, for example, the implementing Members may maintain a statistical report that contains the share of AEO-SMEs among the total trader-SMEs filing Customs declarations.

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7 Border compliance costs imposed on SMEs are analogous to those of security at borders. For example, Ernst & Whinne (1987) estimated that SMEs having fewer than 250 employees suffered from 30-40% higher border compliance costs than larger companies, and found that SMEs were generally not able to participate in “simplified procedures”, which could reduce the costs by 50%. Also, it was reported that the ability to participate in the Swedish “Stairways®” system could reduce costs of large-scale traders by up to 55% (SWEPRO, 2002).
6. Conclusion

35. This paper aims to identify new trends in international trade, conduct research into new business models that are emerging, and recognize and understand the needs of SMEs in preparing the Framework, as mandated by the 2004 PC Resolution.

36. Firstly, a number of new trends in international trade have been observed over recent years. An expansion of world merchandise trade, some notable trends in agricultural and manufactured goods, a surge in trade between RTA partners, growing importance of developing countries, a rise in South-South trade, a wider use of containerized or express cargo, an important role of infra-firm trade, a rapid growth in the global production network, and a wider use of e-commerce are identified among the trends which are relevant in preparing the Framework. As trade is recognized as a vital engine for economic development, it should be borne in mind that the Framework should be implemented to secure global trade without undermining legitimate trade flows, in particular in the context of the new trends in international trade observed in this paper.

37. Secondly, a number of emerging business models in international trade have also been observed over recent years. While the international supply chain remains valid for international transactions and transportation, increasing threats of global terrorism add an important layer of security for anti-terrorism purposes in assessing a supply chain. In the current business models, it is important to facilitate the legitimate flow of trade without compromising national security concerns. In addition, the parallel existence of just-in-case and just-in-time systems, outsourcing to local companies and internationalization of SMEs are observed as some of the emerging new business models. In this sense, the Framework should be carefully designed to align with such emerging business models in order to seek the support of business.

38. Thirdly, it is important to recognize and understand the needs of SMEs in preparing the Framework. As SMEs are a vital source of job creation, export and economic development, the Framework should pay careful attention not to marginalize SMEs from its implementation. The primary SME need is that the Framework will neither cause distortion effects on SMEs nor undermine their business opportunities to participate in the global economy, especially in the emerging business models in international trade. For that, transparency and predictability, capacity building and some support for the AEO arrangement are indicated as examples of the specific needs from the SMEs perspective.
References


