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Committee Secretary
Joint Standing Committee on Foreign Affairs, Defence and Trade

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Re: Additional submission (to original Submission 5) to the Parliamentary Inquiry into Access to Free Trade Agreements by Small and Medium Sized Enterprises (SMEs)

Disclaimer: This submission was written by Associate Professor Melatos in his personal capacity as an academic in the School of Economics at the University of Sydney. The opinions expressed in this article are the author's own and do not necessarily reflect the views of the University of Sydney.

Summary

1. To accurately evaluate the impact of an FTA on both large and small firms, changes to trade at both the “intensive margin” and the “extensive margin” must be identified and measured.
2. A broader (and more meaningful) definition of FTA utilisation needs to be adopted.
3. More data needs to be collected (and centralised) to adequately measure the impact of FTAs on different types of firms.

Evaluating the impact of FTAs at the “intensive margin” and the “extensive margin”

- The formation of an FTA is likely to impact large and small firms differently.
 - ✓ Large firms are likely to already export to (or import from) markets subject to FTA negotiations. Hence, by altering trade costs, the formation of an FTA will most likely result in large firms exporting (and importing) different volumes. That is, the impact of an FTA on large firms will most likely be observed largely at the “intensive margin” of trade.
 - ✓ On the other hand, SMEs may not be trading with a particular market subject to FTA negotiations. As such, by altering trade costs, the formation of the FTA may well result in SMEs exporting to (and importing from) this market for the first time after the FTA is implemented (if the FTA reduces trade costs) or ceasing to export/import (if the FTA increases trade costs). In other words, the greatest impact of an FTA on SMEs may well be observed at the “extensive margin” of trade.
 - ✓ If compliance costs associated with an FTA are higher for SMEs relative to larger firms, then SMEs may withdraw from trading with the market *ex post*



even with a top-line reduction in trade costs. This may occur when reduced trade costs lead to SMEs facing significantly greater competition for their exports (or imports), particularly from larger firms.

- A broader, more meaningful, definition of FTA “utilisation” should be adopted.
 - ✓ The utilisation (i.e. accessibility) of an FTA is usually measured as the proportion of trade using the associated preferences defined by the agreement.
 - ✓ This measure is inadequate as it fails to account for the potentially different impact of the agreement on different types of firms. In particular, the standard definition of utilisation fails to distinguish between:
 - Changes at the intensive margin: Are existing exporters (importers) exporting (importing) more or less *ex post*? and
 - Changes at the extensive margin: Are firms exporting (importing) *ex post* the formation of the FTA that were not exporting (importing) *ex ante*? and
 - “Latent” utilisation: Are there firms (most likely SMEs) that choose not to trade at all within the FTA area but which might with an appropriately designed FTA?
- More and better reporting of FTA compliance costs is required.
 - ✓ Better access to firm-level and, preferably, consignment-level data on exports and imports. This would allow researchers to better understand not just changes to trade volumes (i.e. the intensive margin) following the formation of an FTA but also any changes to the identity of firms trading both before and after the formation of an FTA (i.e. the extensive margin).
 - ✓ More ready access for researchers to customs data on imports at the firm and consignment-level.
 - ✓ Chambers of Commerce and other issuers of certificates of origin could be required to maintain a centralised database which records the details of each consignment for which a CoO has been obtained.
 - Access to certificates of origin data would allow researchers and policymakers to identify individual firms that choose to start (and stop) accessing FTA trade preferences. It would then be possible to find out why they have done so and, in this way, identify and address possible FTA design concerns; e.g. with rules of origin.
 - ✓ More generally, access to the kind of detailed data mentioned above would make it possible to accurately determine how effective FTAs are in meeting the needs of all types of firms, particularly SMEs.

Yours Sincerely,

Mark Melatos