ACCESS TO FREE TRADE AGREEMENTS BY SMALL AND MEDIUM SIZED ENTERPRISES

Submission by Prof. Gabriele Suder, University of Melbourne, to The Joint Standing Committee on Foreign Affairs, Defence and Trade (JSCFADT).

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RE: JSCFADT - Invitation to Professor Suder to make a submission to parliamentary inquiry into SMEs accessing the benefits of free trade agreements

Tariff and non-tariff barriers constitute major trade barriers especially for SMEs to access FTAs (Suder & Lindeque 2018). This includes also product standards and specifications, red tape including Certificate of Origin to prove country-of-origin, visas, and also foreign investment rules, and more.

For example, in product standards and specifications, the EU standards such as the CE marking, but also some ISO International Standards, IEC standards and EU vehicle standards are not fully adopted and accepted in Australia (GACIC 2016, p.2). Australian and European suppliers of finished and intermediate goods and services hence incur significant transaction costs emanating from the procedures required to ensure trade within a cross-border setting.

SMEs are particularly disadvantaged in that they are often under-resourced and focus on core activity only. Yet companies are reportedly efficient in cross-border trade and investment, if they know how to **deal with standards, adopt responsiveness, access FTAs and innovate** accordingly (Suder 2011).

Also, I found in my research in the context of my book 'Doing Business in Europe", that "For SMEs – often the largest group of enterprises to be affected by new policy – there are clear difficulties in putting their views across to policy-makers. SMEs do not usually have the resources which large firms dedicate to influencing policy-making or lobbying. For this reason, the Commission has appointed an SME Envoy and encourages an effective and wide-ranging consultation of SMEs as one element of its "**Think Small First**" principle.' This principle is anchored in the Small Business Act of 2008." (In: Suder 2011, p. 294)

A recent PWC report for DFAT scrutinised FTA utilisation rates in Australia. It has found that "small- and medium-sized enterprises (SMEs) lag behind larger businesses in FTA utilisation, and continued outreach and education is required for these businesses to maximise the opportunities available to them from Australia's FTAs." (Pwc 2018, p.5)
It also reports the needs associated to "compliance costs, digitising forms, providing further education and advocacy (particularly for SMEs), and implementing measures to foster improved understanding of services and investment commitments in FTAs." (Pwc 2018, p.5)
"Only 55 per cent of SME exporters (compared to 77 per cent in large enterprises (i.e. those with greater than 200 employees)) and 40 per cent of SME importers (compared to 94 per cent in large enterprises) claiming the preferential rates of duty available under all Australian FTAs." (p.9)

Transaction costs are reduced because tariffs and quotas are being tackled, but not only: Also, border patrol policies, customs procedures, red tape for example in product testing in case of diverging compliance rules hinder trade: Convergence of the regulatory environment is key to reduce those extensive indirect costs for business.
Also, the reduction of market access uncertainties, procurement and payment systems, are risks for trade and investment, securities, funds and capital, customer and supplier relations (Suder & Lindeque 2018, Box 2.13; Suder 2018). A SME will typically plan to access markets that are the most secure and least costly.

Australia's export business focuses on resources and on small, high-value products that 'can easily access offshore markets to achieve scale and return on investment'. This is supported by an increasingly solid research and development ecosystem in Australia, natural advantages and a propensity to explore ways to deal with distance from final export markets, and/or if they can mitigate risks and costs.

The division of entrepreneurial labour between MNEs and SMEs constitutes global value chains today that constitute more than 75% of trade internationally. In this, large multinational enterprises (MNEs) interact with smaller firms (SMEs) in the internationalization of production (Suder et al, 2015). "SMEs need MNEs to connect with global webs of enterprise, while MNEs have found SMEs invaluable sources of capability in the internationalization of production." The fragmentation of GVCs has been a distinguishing feature of the modern world economy with MNEs contracting with SMEs for tasks, and with differential advantages accruing to both MNEs and to SMEs to ensure these exchanges are efficient" (Suder et al, forthcoming).

The interdependence between MNEs and SMEs in theory implies a large number of SMEs from countries at different stages of economic development entering cross-border exchanges in which Australia would be expected to be represented.

Unfortunately, the overall contribution of foreign suppliers to Australian exports in value added terms to date remains low, and vice versa. The OECD reports it to be situated at the very low end of any OECD member economy. This means that Australia deals with a very high share of domestic value added, of almost 90 %. Worldwide studies have shown that this results from SME access issues and may lead to a lack of innovation access through GVCs as well a lack of long-term resilience of economies to shock.

The potential of Australian SMEs is high: On offer are niche solutions and have evidenced capability in particular in additive manufacturing, automation, artificial intelligence, big data and analytics, blockchain, cloud, cyber security, immersive simulation, the Internet of Things and systems integration, amongst other (DFAT).
DFAT has made a clear case that GVC participation is "One of the key areas of opportunity for Australian business" (DFAT, 2017, http://dfat.gov.au/about-us/publications/trade-investment/business-envoy/Pages/january-2018/tapping-into-global-value-chains.aspx)

This necessitates the participation of trade partners in global production and services networks, as part of the international fragmentation of production. On one hand, this participation, if positioned on the high value- added side of GVCs, increases job creation and economic growth through trade know-how, exchange and innovation. One the other, business benefits from integrating the know-how of both lead firms and suppliers of key components along stages of production and in multiple offshore locations, which allows for productivity growth (Inomata 2017). This means that organisations embed more technology and know-how agriculture, manufacturing, and services production, favour Foreign Direct Investment (FDI), and invest in services innovation that link GVCs. Australia, known for its openness for trade and investment, has 23 per cent of manufacturing firms engaged in services, with most in resources, i.e., at the beginning or is otherwise positioning itself at the very end of GVCs only.

Remaining non-tariff barriers for in-and out-puts of chain compared to its main trade partners yet hamper business capacity to maximise value added, i.e, the ability to tap into high value added in mid-GVC and to support the production and start-of- assembly of processed products (beating the remoteness factor for finished products) or specializing in customer services (in addition to business and resources focused services).
Considerations for broadening access to Public procurement at home and abroad through GVCs, moving towards self-certification and convergence in compliance, including for country of origin rules, plays an important role.

Additional support for better participation in the mid- stages of the GVC will allow SMEs to demonstrate often unique and less imitable knowledge and sophistication of goods and services capabilities, i.e., creating networked provider dependencies, and help close the gap in distance to final demand. An upstream supplier exports intermediate goods to a downstream producer, who adds value to these intermediate goods for further export until final consumption.

Access to FTA advantages for SMEs are

- highly dependent on (ex-ante) FTA negotiations that strive to remove the above mentioned barriers to trade, given the significant impact this has on SME participation in both intermediate (GVC) and finished goods and services trade;
- and highly dependent on ex-Post impact survey, evaluation and action planning to support training and advice.

Governmental and public-private support & training initiatives are strongly encouraged. Also, SME support platforms have been experimented successfully abroad, including: here: http://ec.europa.eu/small-business/most-of-market/business-procurement/index_en.htm .
Euro Info Centres, for example, help SMEs adapt to threats and opportunities, to find partners, and provide information about prevalent legislation.
The *Enterprise Europe Network* establishes the world's largest support network specifically for internationalising SMEs. The EU reports that "it has 3,000 experts across 600 member organisations in more than 60 countries." They are located at EU member states' chambers of commerce, Eurochambers (comprehensively representing EU business interests), and various organisations. In Brazil for example, Eurochambres is the official most representative organisation for European businesses of all sizes in Brazil – more than 5000. Some of the firms that are members have been in Brazil for more than 100 years, some only arrived just recently. There are also chambers of member states in all regions, serving also

other member states' interests as needed. The EU Delegation has its office in Brasilia, where most embassies are also located and member states' consulates are spread across the country and can be addressed. In addition, there rea offices such as a Danish Business Centre with an incubator facility in Sao Paolo, as well as other types of representations and trade offices. An online support, advice and partnership service can be accessed from around the world (https://een.ec.europa.eu/). The underlying **Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) program** is also accessible for EEA countries. It is supported by the European Fund for Strategic Investments (EFSI), part of the Investment Plan for Europe initiative that helps reduce market failures. Applications for EFSI funds can be made via http://ec.europa.eu/growth/industry/innovation/funding/efsi_en . (Suder & Lindeque 2018).

As I am detailing in a forthcoming article in AJIA (2018), "For business organisations, the primary interest in accessing FTAs is mainly revenue –and policy driven, that is, by enhancing market presence to foster trade, investment and capabilities on one hand, and in the other, by the opportunity to participate in setting standards, norms and regulations for international trade flows in an often broader than bilateral sense. Some companies, reportedly often under-resourced SMEs, are aware of potential FTA benefits yet unaware of how to access FTAs and their preferential conditions, and need to dedicate additional resources to access FTA benefits. They gather as associations or individually around government resources (e.g., information seminars and roundtables) to obtain the necessary information and express their opinions.
It is part of the government's pre-consultation to provide sufficient and the most representative opportunity to them and for all identified stakeholders to have a voice and submit opinions. (…) There is broad recognition of the importance that the reduction on tariff- and non-tariff- barriers has on business operations and revenue, and on the competitiveness of industry on local and global level. There is also awareness that FTAs cannot function without at least some level of business buy-in, given their very nature and rationale."

Both, the FTA negotiations and the preceding and following support initiatives need to be designed and strengthened to serve SMEs also that are increasingly using the Internet as a channel for doing business, accompanying the increasing preference to use the Internet and e-commerce to make online web purchases (intra-company, C2C, C2B and B2B).
They may also specifically consider the varying operation models of the growing number of e-commerce platforms and marketplaces. Coming back to EU examples as a benchmark, a common European e-payment scheme allows any merchant or SME present on the Internet to receive payments from consumers securely and efficiently. These benefits are available to all companies conducting cross-border business or operating locally.

"Early and rapidly internationalized structures can be found in Born Globals, that is, firms that are international by 'birth', such as global start-ups or instantly globalizing high-technology firms, online services and IT (information technology) security solutions. These corporations, often of SME size, rely heavily on their network structure and the diversity of the value added of each component of this structure: advantages in the use of

resources, procurement, distribution and cross-border sales characterize this form of diversification and corporate risk reduction.
At the same time, Born Globals need to be run with a global vision and a network relying on the '**know your customer, your supplier and your distributor'** principles more than traditionally internationalizing firms. (…) given entrepreneurs' increasing awareness of the value creation that is possible through harmonized networks of transportation and communications, of market expertise through the proximity of European markets, and cross-cultural competencies." (Suder 2011, p.201)

It is my recommendation that the on-going and future support for small and medium Australian export-oriented businesses that are seeking to leverage free trade agreements for the export of goods and services, is fostered upon these considerations.
I remain available to the Sub-Committee to discuss these considerations in further detail.

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