STUDY

EUROPEAN PARLIAMENT

DIRECTORATE GENERAL EXTERNAL POLICIES OF THE UNION

Policy Department External Policies

SMEs AND INTERNATIONAL TRADE

INTERNATIONAL TRADE

October 2008

EN

This study was requested by the European Parliament's Committee on International Trade.

This study is published in the following languages: English (OR), French, Italien

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Publisher European Parliament

Manuscript completed on 29 October 2008.

The study is available on the Internet at
http://www.europarl.europa.eu/activities/committees/studies.do?language=EN

If you are unable to download the information you require, please request a paper copy
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Brussels: European Parliament, 2008.

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EXECUTIVE SUMMARY (EN)

Recent empirical evidence on the international activities of European firms shows that efficiency gains from exporting seem to accrue only to medium and large exporters, due to the presence of relevant fixed costs in the exporting activity. The surveyed policies on the status of SMEs in international trade practices have shown that fixed costs are likely to persist in the future, due to the increasing complexity of international trade operations, and the lack of a systematic policy related to SMEs within the multilateral negotiating framework.

Even within a regional approach to economic integration (regionalism), the existence of significant costs of implementation in the rules of origin act as an important obstacle for the access of SMEs to the integrating area.

Some proposals specifically related to SMEs start being discussed in international fora (specific provisions for SMEs within FTAs, or a special clause on SMEs needs within the WTO negotiations), but practical actions are still lacking. The same discussed changes to provisions on geographical indications of products or public procurement do not seem to be specifically centred on the needs of SMEs, and thus are not likely to significantly foster their involvement in international trade activities.

In the absence of policies aimed at a systemic reduction of fixed costs for SMEs within the working of international markets, Governments have been trying to reduce the fixed costs of their international involvement via a number of export promotion policies. However, the results of these policy actions are not clear-cut, with the surveyed evidence pointing to mixed results obtained in terms of effective support for the internationalization of SMEs.

Moreover, even provided that successful export promotion policies can be designed, leading to an actual boost of exports of SMEs, some of these policies risk distorting the allocation of economic activity at the detriment of the more productive firms (irrespective of their size), with a net loss for the overall productivity of the country, and thus against the goals of the Lisbon agenda.

Rather than trying to reduce the fixed costs of exporting, a more efficient, and less distortive, way of supporting the internationalization of SMEs would instead try to affect the exporting status indirectly, through measure aimed at reducing their operational fixed costs in order to increase their productivity. Innovation and entrepreneurship-promotion policies, together with the recently approved EU Small Business Act, are right steps in this direction.

Once SMEs reach a high enough productivity threshold via these policies, they will be able to afford the costs of exporting and will ‘naturally’ become international players.

EXECUTIVE SUMMARY (IT)

La recente evidenza empirica sulle attività internazionali delle imprese europee suggerisce che i guadagni di efficienza derivanti dall'attività di esportazione riguardano solamente le imprese di dimensioni medie e grandi. Ciò avviene a causa dei consistenti costi fissi legati all'attività di esportazione stessa. Analizzando le principali politiche economiche legate allo status delle PMI nel commercio internazionale, si nota che, con ogni probabilità, questi costi fissi continueranno ad essere persistenti, sia a causa della crescente complessità del commercio internazionale, sia per l'assenza di una politica sistematica per le PMI all'interno delle negoziazioni multilaterali.

Anche nell'ambito di un approccio regionale all'integrazione economica (regionalismo), l'esistenza di significativi costi di implementazione delle "regole di origine" agisce come deterrente per l'accesso delle PMI alle aree di libero scambio.

Alcune proposte specificamente indirizzate alle PMI iniziano ad essere discusse nei fora internazionali (regole semplificate specifiche per le PMI all'interno delle aree di libero scambio, oppure clausole speciali sulle esigenze delle PMI nell'ambito delle negoziazioni dell'OMC), tuttavia al momento decisioni concrete in questo ambito sono ancora assenti. Modifiche legislative attualmente in discussione nell'ambito delle regole sulle indicazioni geografiche dei prodotti o sugli appalti pubblici internazionali non sembrano essere specificamente centrati sulle esigenze delle PMI, e quindi difficilmente saranno in grado di favorirne in maniera significativa il coinvolgimento delle stesse negli scambi internazionali.

In assenza di politiche mirate alla riduzione sistematica dei costi fissi che le PMI incontrano operando nei mercati internazionali, i Governi hanno cercato di intervenire per ridurre tali costi attraverso una serie di politiche di promozione delle esportazioni. Tuttavia, i risultati di queste politiche sono ambigui, e dall'analisi dei casi considerati non risulta una chiara evidenza a favore di un effettivo supporto all'internazionalizzazione delle PMI.

Inoltre, assumendo che sia possibile disegnare delle politiche di sostegno all'internazionalizzazione efficaci, in grado di aumentare effettivamente le esportazioni delle PMI, alcune di queste politiche potrebbero distorcere l'allocazione delle attività economiche, a tutto svantaggio delle imprese più produttive (indipendentemente dalla loro dimensione), con una perdita netta di produttività aggregata per il paese, dunque in contrasto con gli obiettivi dell'agenda di Lisbona.

Piuttosto che tentare di ridurre i costi fissi legati all'attività internazionale, una via più efficiente, e meno distorsiva, per sostenere l'internazionalizzazione delle PMI passa attraverso l'utilizzo di misure rivolte a ridurre i costi fissi operativi di tali aziende in funzione di un aumento della loro produttività, e dunque, indirettamente, della loro capacità di esportazione. Politiche di promozione dell'innovazione e dell'imprenditorialità, congiuntamente con lo "Small Business Act" di recente approvazione sono un passo nella giusta direzione.

Una volta raggiunte soglie di produttività sufficientemente elevate, grazie a politiche orientate in tal senso, le PMI saranno in grado di sostenere i costi fissi dell'attività di esportazione senza sostegni pubblici, e saranno dunque naturalmente orientate ad una maggiore partecipazione internazionale.

1. Introduction

Micro, small and medium-sized enterprises (SMEs) are often referred to as the backbone of the European economy. They represent 99 % of all enterprises in the EU and provide around 65 million jobs. The situation is not different outside the EU: SMEs are key contributors to the economic growth and employment in the global economy. They make up more than 95 percent of developed countries' enterprises and account for 60 to 70 percent of their workforce. We believe the situation is quite similar in developing countries. For example, in Latin America and the Caribbean, SMEs also make up more than 95 percent of the total number of business establishments and absorb more than 85 percent of total private sector employment in most countries in the Region.

Within the EU, the current definition of SMEs is stated in the Recommendation 2003/361/EC, which replaced Recommendation 96/280/EC as from 1 January 2005. The revision increases legal certainty, while reducing possibilities of its abuse, particularly with regard to state aid, Structural Funds and the Research and Development Framework Programme[1]. Firms are defined according to the following criteria:

Enterprise category	*Headcount*	*Turnover*	*Balance sheet total*
Medium-sized	< 250	≤ € 50 million	≤ € 43 million
Small	< 50	≤ € 10 million	≤ € 10 million
Micro	< 10	≤ € 2 million	≤ € 2 million

While it is compulsory to respect the staff headcount thresholds, an SME may choose to meet either the turnover or balance sheet ceiling. It does not need to satisfy both and may exceed one of them without losing its status. The new definition foresees such an option since, by their nature, enterprises in the trade and distribution sectors have higher turnover figures than those in manufacturing. Providing an option between this criterion and the balance sheet total, which reflects the overall wealth of an enterprise, ensures that SMEs engaged in different types of economic activity are treated fairly.

[1] Due to their limited human and financial resources, SMEs face particular difficulties within a growing integrated market. Recognising these problems, the EU and national legislations try to redress these difficulties by granting various advantages to SMEs. To this extent, a legally secure and user-friendly definition is thus necessary in order to avoid distortions in the Single Market.

The main source of data for an analysis of SMEs in Europe is Eurostat's structural business statistics (SBS), which describe the structure and performance of economic activities, down to the most detailed activity level (several hundred sectors), with a breakdown by size-class. Figure 1 reports the breakdown of value added by enterprise size-class within industries. SMEs presence is massive (around 75% of sectoral value added) in construction and services (all but transport, storage and communication) and is relevant also in manufacturing (almost 50% of value added). If we consider the share of employment in SMEs by sectors (Figure 2) we obtain a similar picture, although percentages are even higher. This data suggest that SMEs are concentrated in relatively labour-intensive production processes, with possibly a lower labour productivity, as suggested by Figure 3.

If we consider the presence of small and medium-sized enterprises across EU countries, we observe that micro enterprises are generally the most relevant category in terms of percentage of employment, ranging from 17% in Lithuania to 59.6% in Greece. (Table 1)

If we look at the numerosity of different enterprise size classes, we observe that micro firms are 90% of total firms (Figure 4). This share varies across countries, being higher in Greece, Sweden, and Italy among EU 15 countries and in Poland, Czech Republic, and Hungary among EU 12. If we compare EU 15 and EU 12 averages (Figure 5) we find some slight differences: on average, New Member States have a higher share of micro firms than EU 15 countries, probably due to the effect of enterprise creation following their transition from plan to market. On the other side, EU 15 countries have a larger percentage of small firms, which suggests, in an equilibrium configuration, the higher propensity of EU15 countries to be relatively more specialized in sectors characterized by lower minimum efficient scale (e.g. services). Overall, the percentage of large firms is almost identical in the two areas (2,3% in EU 12 vs. 2,1% in EU 15)

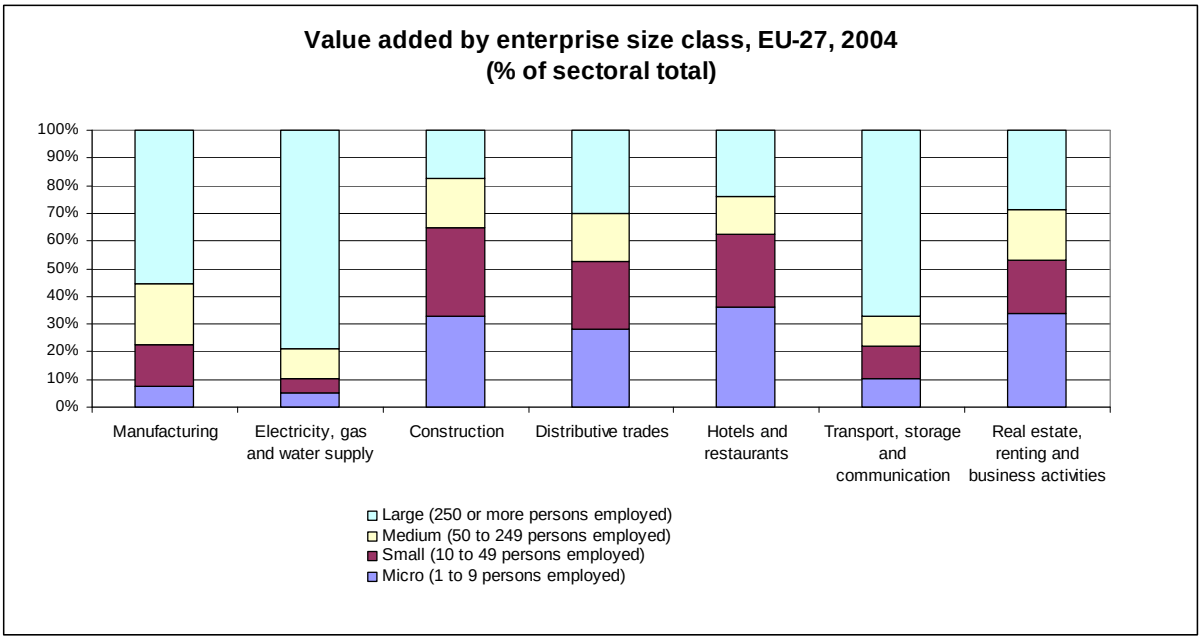

Figure 1: Value added by enterprise size class

(Source: Eurostat, own calculation)

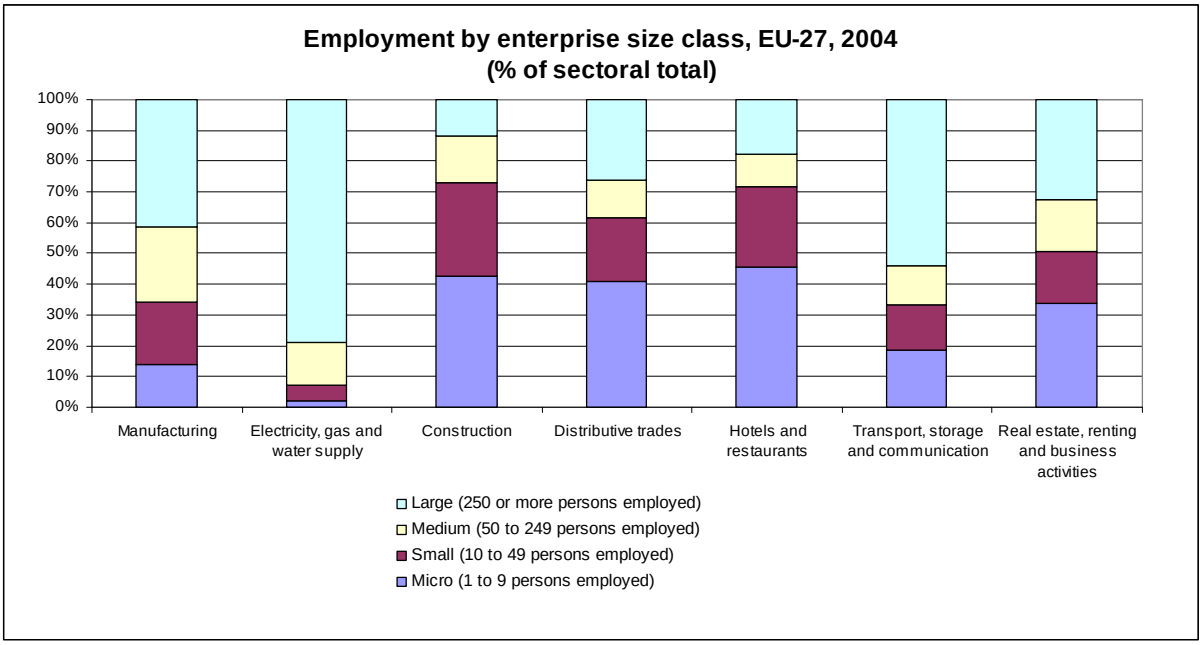

Figure 2: Employment by enterprise size class

(Source: Eurostat, own calculation)

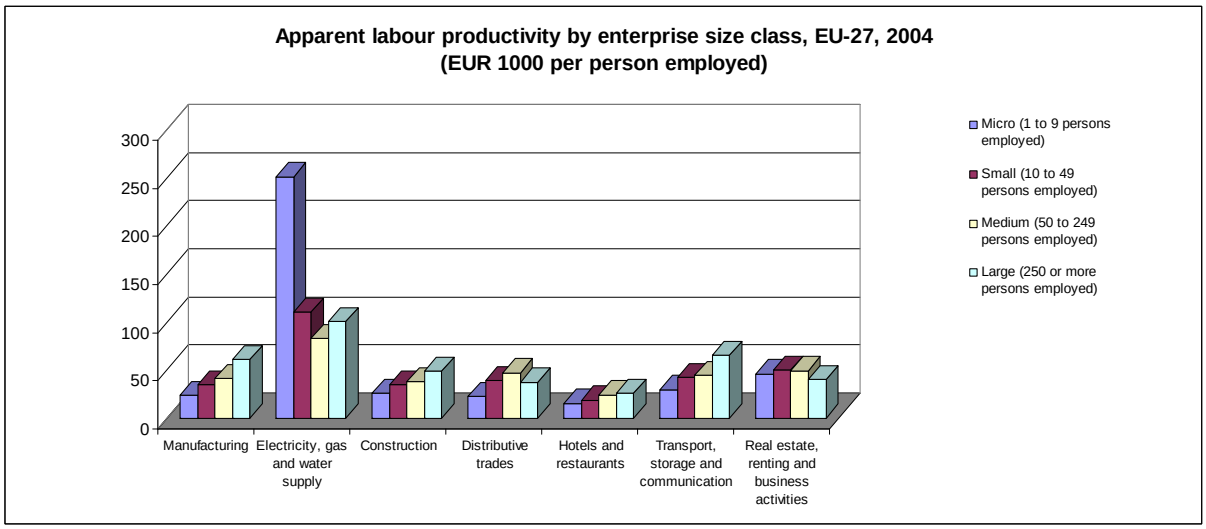

Figure 3: Apparent labour productivity by enterprise size class

(Source: Eurostat, own calculation)

Table 6.6: Number of persons employed by enterprise size class, non-financial business economy, 2004

		Share in total employment (%)			
	Number of persons employed (1 000)	Micro (1 to 9 persons employed)	Small (10 to 49 persons employed)	Medium-sized (50 to 249 persons employed)	Large (250+ persons employed)
EU-27 (1)	*125 000*	*29.5*	*20.8*	*16.8*	*33.0*
Belgium	2 383	29.6	:	15.5	:
Bulgaria	1 771	29.3	21.3	21.0	28.3
Czech Republic	3 573	31.8	18.4	18.7	31.1
Denmark	1 660	20.0	:	21.1	:
Germany	20 687	19.2	21.9	19.0	39.9
Estonia	384	23.2	27.7	:	:
Ireland	:	:	:	:	:
Greece	2 435	59.6	:	:	:
Spain	12 839	38.9	25.5	14.7	20.9
France	14 287	23.6	20.6	16.7	39.1
Italy	14 687	46.9	21.9	12.4	18.8
Cyprus	:	:	:	:	:
Latvia	593	22.6	26.2	26.3	25.0
Lithuania	794	17.0	26.4	27.9	28.7
Luxembourg	204	19.7	:	:	:
Hungary	2 474	37.3	:	:	27.8
Malta	:	:	:	:	:
Netherlands	4 609	29.2	20.9	17.3	32.6
Austria	2 354	25.2	23.4	:	:
Poland	7 484	40.1	11.7	18.5	29.7
Portugal	2 944	:	:	:	:
Romania	4 001	18.5	17.2	22.5	41.8
Slovenia	568	:	:	:	:
Slovakia	895	:	:	22.5	48.8
Finland	1 214	22.3	:	:	:
Sweden	2 578	26.3	20.3	17.7	35.8
United Kingdom	17 993	21.1	18.0	14.8	46.1

(1) Rounded estimates based on non-confidential data.

Source: Eurostat (tin00052)

Table 1: Employment by enterprise size class, country breakdown

(Source: Eurostat Yearbook 2008)

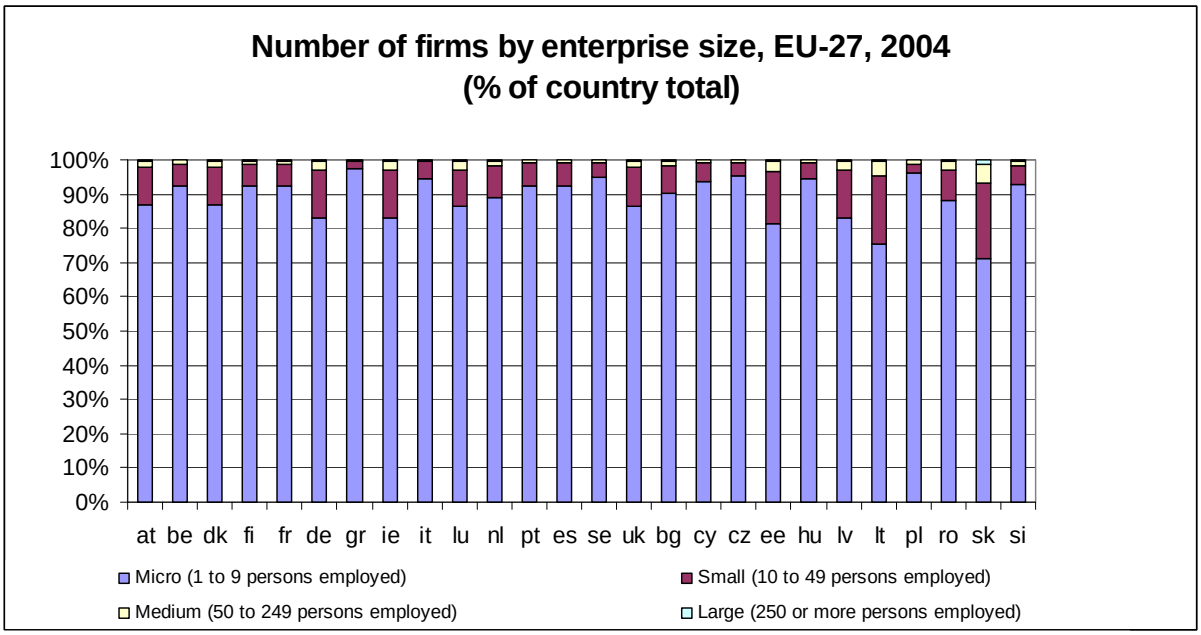

Figure 4: Number of firms by enterprise size class, country breakdown

(Source: Eurostat, own calculation)

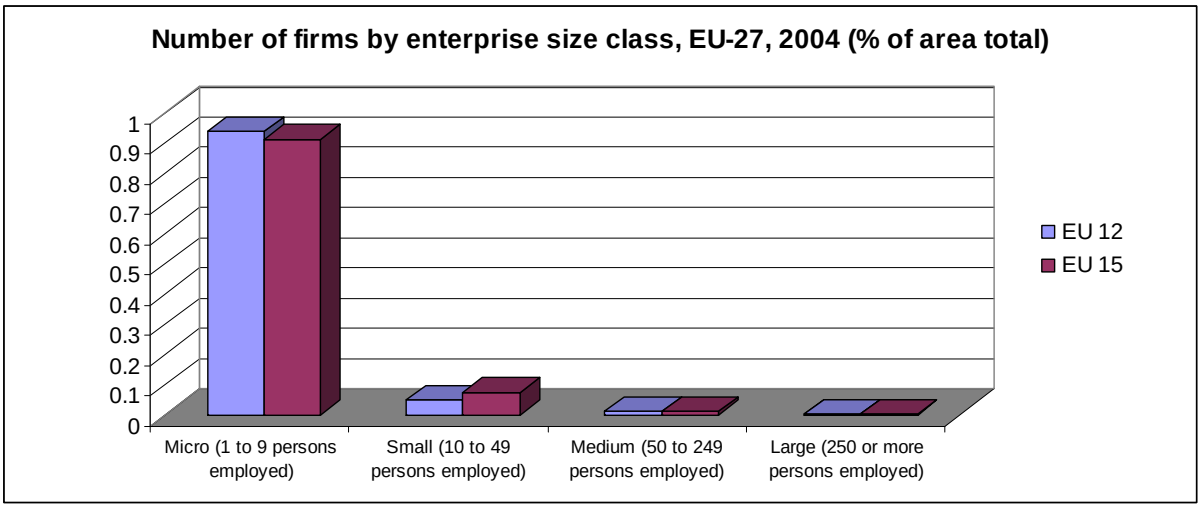

Figure 5: Number of firms by enterprise size class

(Source: Eurostat, own calculation)

2. SMEs and International Trade

There is a clear understanding in the business literature (e.g. Graham, 2004) that SMEs tend to focus only on their distinctive competency. That is, they can exploit at best the flexibility and adaptability entailed by their limited size and often informal hierarchies, and thus become extremely competitive at producing their product or service or developing their new technology. On the other hand, SMEs tend to be not so good at actually selling their output in the global marketplace, since they have a tendency to think that their product, technology or service will sell itself just because it is so good. Now, while the availability of a competitive output is a necessary condition for a long-lasting presence in the market, it is nevertheless less and less a sufficient condition for achieving success in the global marketplace.

In other words, we observe a growing gap between the factors leading to ***inward competitiveness*** (i.e. what allows you to produce efficiently) and those responsible for ***outward competitiveness*** (i.e. what makes you a successful firm in the global markets).

Such a growing gap is due to at least two structural changes that are taking place in the market place, herein summarised.

First of all, we observe increasing evidence of ***production disintegration***. The last few decades have seen a spectacular integration of the global economy through trade. For example, the share of imports (or exports) in GDP for the United States has approximately doubled in the last two decades, and if intra-OECD trade is omitted, the same is true for the OECD countries generally. But while international trade volumes have grown dramatically, equally dramatic changes have occurred in the nature of trade. One of the most important changes involves the increasing interconnectedness of production processes in a vertical trading chain across different countries, with each country specializing in particular stages of a good's production sequence. Just to quote a famous example from the business literature, an electric toothbrush by Philips sold in the United States is currently produced in eleven different production sites in nine different countries, in three continents: electric parts are made in China, Malaysia, Taiwan and assembled in Philippines; metal parts are made in Sweden, Austria and France; accumulators and batteries in France and Japan; everything is then sent to a final assembly plant in the United States, while another plant takes care of packaging and, finally, distribution. Such a process of production disintegration leading to an increase in the trade of intermediate products is currently the fastest growing component of international trade, as summarised in Box 1.

Box 1. The increasing disintegration of trade flows

Feenstra (1998) compares several different measures of foreign outsourcing, finding that they have all increased since the 1970s. He shows that merchandise trade as a share of GDP has steadily risen after the Second World War, but for some countries is still below 1913 level.

Ratios of Merchandise Trade to GDP *(percent)*

Country	*1890*	*1913*	*1960*	*1970*	*1980*	*1990*
Australia	15.7	21.0	13.0	11.5	13.6	13.4
Canada	12.8	17.0	14.5	18.0	24.1	22.0
Denmark	24.0	30.7	26.9	23.3	26.8	24.3
France	14.2	15.5	9.9	11.9	16.7	17.1
Germany	15.9	19.9	14.5	16.5	21.6	24.0
Italy	9.7	14.4	10.0	12.8	19.3	15.9
Japan[a]	5.1	12.5	8.8	8.3	11.8	8.4
Norway	21.8	25.5	24.9	27.6	30.8	28.8
Sweden	23.6	21.2	18.8	19.7	25.0	23.5
United Kingdom	27.3	29.8	15.3	16.5	20.3	20.6
United States[b]	5.6	6.1	3.4	4.1	8.8	8.0

The data presented are for industrial countries, which have had increasing shares of their economies devoted to services rather than ‘‘merchandise’’ trade like manufacturing, mining and agriculture. To offer a different perspective, Feenstra measure merchandise trade relative to merchandise value-added.

Ratios of Merchandise Trade to Merchandise Value-Added *(percent)*

Country	*1890*	*1913*	*1960*[a]	*1970*	*1980*	*1990*
Australia	27.2	35.6	24.4	25.6	32.4	38.7
Canada	29.7	39.4	37.6	50.5	65.6	69.8
Denmark	47.4	66.2	60.2	65.9	90.0	85.9
France	18.5	23.3	16.8	25.7	44.0	53.5
Germany	22.7	29.2	24.6	31.3	48.5	57.8
Italy	14.4	21.9	19.2	26.0	43.1	43.9
Japan	10.2	23.9	15.3	15.7	25.8	18.9
Norway	46.2	55.2	60.0	73.2	70.9	74.8
Sweden	42.5	37.5	39.7	48.8	72.9	73.1
United Kingdom	61.5	76.3	33.8	40.7	52.6	62.8
United States[c]	14.3	13.2	9.6	13.7	30.9	35.8

There are still two countries for which the ratio of merchandise trade to merchandise value-added was larger in 1913 than in 1990 (Japan and the United Kingdom) and one other for which this ratio changed little (Australia). But all the other countries have experienced substantial growth in trade relative to merchandise value-added since 1913: this ratio has increased by about one-third for Denmark and Norway and by three-quarters for Canada; has doubled for France, Germany, Italy, and Sweden; and has nearly tripled for the United States. Merchandise trade has indeed grown substantially relative to the production of these commodities in many countries.

Hummels, Ishii and Yi (2001) develop the concept of “vertical specialization” (VS), the key feature of which is that imported inputs are used to produce a country’s export goods. This concept emphasizes the twin notions that the production sequence of a good involves at least two countries, and that during this sequence, the good-in-process crosses at least two international borders.

They construct a measure of vertical specialization which measures the value of imported inputs embodied in goods that are exported. They use OECD input-output tables, which provide industry-level data on imported inputs, gross output, and exports. They find that, as of 1990, VS exports in OECD countries (plus Ireland, Korea, Taiwan and Mexico) represent more than 21% of total exports, and had grown almost 30% since 1970. Moreover, VS growth accounts for 1/3 or more of overall export growth.

The implication for SMEs of trade disintegration is that the fixed costs of setting up international production are now higher, since the latter is likely to require the interconnection of the same process with a global network of suppliers / customers.

On the other side, the revolution in ICT itself is changing the way ***trade transactions*** are organised. Buying and selling in global markets, up until very recently, was generally speaking an undertaking specifically achieved by the use of an intermediary. In most cases, the intermediary was a global trading company. Communications used to take place via telex machine, which was a relatively expensive machine, and required trained operators. With the advent of facsimile, trading became easier, and large firms started doing intermediary activities by themselves. Suddenly, global trading companies who had dominated import-export trade for most of the 20th century found themselves locked into competition with their clients (manufacturers and service providers) for the most highly-skilled employees available. Many manufacturers discovered that they could hire in-house international business specialists who could perform most of the actual marketing functions of the intermediary and for significantly less money.

The implication for SMEs of such a change has been that, since large firms no longer pay the fixed costs of having trading companies in place, the latter shrunk and eventually in many cases disappeared; as a result, SMEs do not benefit any more from such a positive externality (the presence of specialised trade intermediaries), and have eventually to pay the fixed costs of setting up such a specialised activity on their own if they want to tackle international markets.

As a result, both structural changes taking place in the global market place imply an **increase of fixed costs** for SMEs aspiring to compete internationally. Hence, given the traditional constraint on human and financial resources characterizing SMEs, we can expect SMEs to face increasing difficulties in participating in international trade activities.

Recently available empirical evidence on the international activities of firms across the EU is actually consistent with such an intuition.

Mayer and Ottaviano (2007) present evidence on a sample of over 100,000 firm in six countries (Germany, France, United Kingdom, Italy, Hungary and Norway). They find that internationalized firms (which they define as firms involved in international activities through exports or foreign direct investment) are rare, and their distribution is highly skewed. In other words, aggregate exports are driven by a small number of top exports: the top 1%, 5% and 10% of exporters account for 40%, 70% and 80% respectively of aggregate exports, as shown in Table 2 below.

Country of origin	Top one percent	Top five percent	Top 10 percent
Germany	59	81	90
France	44 (68)	73 (88)	84 (94)
United Kingdom	42	69	80
Italy	32	59	72
Hungary	77	91	96
Belgium	48	73	84
Norway	53	81	91

Source: EFIM. Note: France, Germany, Hungary, Italy and the UK have large firms only; Belgian and Norwegian data is exhaustive. Numbers in brackets for France are percentages from the exhaustive sample[5].

Table 2: Share of exports for top exporters in 2003, total manufacturing
(Source: Mayer and Ottaviano, 2007)

Just to give an idea of the degree of concentration, in the case of France reported above, for example, around 70% of total French exports is made by less than 200 firms (corresponding to the top 1% of exporters).

These data are confirmed by another study, financed by the European Commission (Micro-Dyn) which, using different databases for seven european countries (Bulgaria, France, Hungary, Italy, Poland, Slovenia and Spain) collects information on some 195,000 firms. They find similar results on the export concentration, as reported in Table 3.

	Top 1%	**Top 5%**	**Top 10%**
Bulgaria	39.9	61	76.3
France	46.12	70.38	80.64
Hungary	55%	75%	83%
Italy	32%	59%	72%
Poland	35.90%	59.90%	70.70%
Slovenia	38.22%	66.32%	78.90%
Spain	60.90%	80.00%	87.90%

Table 3: Share of exports for top exporters
(Source: Altomonte, 2008))

Considering for example Italy, both study show that the country has the less concentrated exporting activity among the considered member States, a feature consistent with the Italian industrial structure of internationally competitive small and medium-sized enterprises.

Nevertheless, Italy still gathers a third of its exporting activity concentrated in the top 1% largest exporters, and its top 10% exporters account for 72% of total trade.

The high level of concentration of exports indicates evidence of the high fixed costs entailed by the international trading activity, which can be paid only by those (relatively fewer) firms efficient enough to afford them. Hence, due to the presence of higher fixed costs, there seems to be a clear correlation between firms' efficiency (or productivity) and their participation to international markets.

These findings are perfectly in line with recent theories of international trade based on firm heterogeneity. Melitz (2003) has demonstrated how differences in productivity translate into differences in internationalization status of firms. We observe a partition of firms according to their productivity. Following a trade liberalization, least productive firms make losses in their home markets without gaining access to foreign markets, and are therefore forced to exit. Firms with intermediate levels of productivity survive but, not being productive enough to access foreign markets, are relegated to home sales only and their market shares fall. Finally, the most productive firms are able to compensate for lost profits on home sales with new profits on foreign sales, they survive and expand their market shares, and tend to grow bigger. The overall effect of international trade integration is to eliminate the least productive firms, generating an increase in average productivity through the reallocation of productive resources from less to more efficient producers.

The latter intuition is confirmed by the empirical evidence, since both studies show that internationalized firms, i.e. those who can pay the fixed costs of international activities, tend to be larger in size, generate higher value added, pay higher wages, employ more capital per worker and more skilled workers and have higher productivity, as shown in Table 4.

The data on employment are particularly significant for our analysis. Consistently with our previous intuition of the relative disadvantage generated for SMEs by the structural changes taking place in international trade activities, we observe that exporting firms are on average 120% larger. The smallest coefficient is found in Poland, where exporting firms are "only" 33% larger, but this result could be due to the different sample for this country: Polish firms are subject to a threshold of 50 employees, therefore the gap between large and small enterprises is artificially shrunk. In Italy, where as we have seen the export activity is more dispersed across firms, the size premium is still 87%, i.e. firms engaged in international activities are almost twice as large as the average Italian firm. This data thus clearly shows that, due to the presence of significant fixed costs in carrying international activities, it exists a **negative correlation between firm size and international involvement** of firms.

	Bulgaria	Hungary	Spain	Italy	Poland [(a)]	Slovenia
	All exporting plants – general definition					
Size:						
Sales/output	2.067***	2.29***	0.461***	0.871***	0.639**	2.151***
Employment	1.790***	1.64***	1.631***	0.663***	0.337**	1.726***
Capital per worker	0.891***	0.50***	0.253***	0.231***	0.334**	0.599***
Performance:						
VA per worker	0.314***	2.11***	0.356***	0.262***	0.182**	0.181***
Average wage	0.537***	0.45***	0.084***	0.068***	0.146**	0.180***

[(a)] Numbers for Poland are average values of the premia estimated on annual basis and presented in the country paper (Tables 9a-9j). Polish firms are subject to a threshold of at least 50 employees.

Table 4: Exporters' characteristics and performance
(Source: Altomonte, 2008)

Another piece of evidence supporting the relationship between firms' size and their international involvement is provided in Table 5, analyzing evidence on the pattern of market access of exporting firms. Using information on the French sample they show that a bipolar pattern takes place when we consider the number of products exported, and the number of countries targeted: almost 30% of firms export only one product to only one market, while around 11% of firms export more than ten products in more than ten countries.

Nonetheless, if we look at the pattern of French exports we observe that over 75% of the value of total exports comes from firms that export more than ten products in more than ten countries. This evidence suggests that top exporters export many products to many locations. Overall, aggregate exports are mainly determined by a few top exporters that are relatively big and supply several foreign markets with several differentiated products.

Once again, these findings are consistent with the existence of a process through which only firms that are large enough and a have a rich enough portfolio of products can withstand international competition.

Share of French exporters in 2003 (total number exporters: 99259)

	Number of countries			
No. of products	1	5	10+	Total
1	29.61	0.36	0.22	34.98
5	0.76	0.45	0.62	4.73
10+	0.95	0.89	10.72	18.57
Total	42.59	4.12	15.54	100

Share of French exports in 2003 (total exports: 314.3 billion €)

	Number of countries			
No. of products	1	5	10+	Total
1	0.7	0.08	0.38	1.86
5	0.3	0.08	1.06	1.97
10+	0.28	0.45	76.3	81.36
Total	2.85	1.55	85.44	100

Table 5: Distribution of French exporters over products and markets
(Source: Mayer and Ottaviano, 2007)

A first policy implication thus arises from the above analysis: if we want to promote the international dimension of SMEs, starting from their participation to the Single Market, we need to act in order to reduce their fixed costs of involvement in international activities. The various sources of these costs, and some of the actions undertaken to reduce them, are presented in the next Section.

3. SMEs and the fixed costs of international involvement

3.1. The European Union playing field

A frequent argument heard when dealing with the internationalization process of SMEs is that Government should intervene to create a "level playing field" for them, in order to reduce their structural weaknesses (and thus higher fixed costs) that, as we have seen, put them at disadvantage versus larger firms in international markets.

To this extent, the "**Small Business Act**" (SBA) recently put forward by the European Commission (June 2008) is a step in the right direction. In fact, the SBA entails new legislation in four areas that particularly affect SMEs:

- a new General Block Exemption Regulation on state aids, which will simplify procedures and reduce costs. It will increase the aid intensity for SMEs and make it easier for SMEs to benefit from aid for training, research and development, environmental protection and other types of aid;
- a new statute for a European Private Company allowing a "Société privée européenne" (SPE) to be created and operate according to the same uniform principles in all Member States. It has been designed to address the current onerous obligations on SMEs operating across borders, who need to set up subsidiaries in different company forms in every Member State in which they want to do business, in particular in services industries. In practical terms, the SPE would mean that SMEs can set up their company in the same form, no matter if they do business in their own Member State or in another. Opting for the SPE will save entrepreneurs time and money on legal advice, management and administration;
- a new proposal on VAT which, if adopted, will offer Member States the option to apply reduced VAT rates for locally supplied services, including labour intensive services, which are mainly provided by small and medium enterprises.
- an amendment to the directive on late payments, to help to ensure that SMEs are paid within the 30 day time limit stipulated.

More in general, in addition to the standing commitment to cut administrative burden by 25% by 2012, the Commission also encourages member States to implement legislation such that, across the Single Market, the time needed to start a new company should not exceed one

week, the maximum time to obtain business licenses and permits should not surpass one month and one-stop-shops should assist to facilitate start-ups and recruitment procedures.

In terms of supporting the international activities of SMEs, all these proposals seem to go in the right direction, in that they can significantly contribute to reduce the fixed costs of operations for small and medium-sized enterprises and thus foster their internationalization strategies. It is therefore important that the Council and the European Parliament quickly approve the forthcoming legislative proposals by the European Commission.

Most importantly, it is fundamental to monitor the **quality of implementation** of the new SME-related legislation (at both the national and EU-level), having well in mind the "Think Small First" principle: more often than not, in fact, the national implementation of EU legislation aimed at reducing costs for SMEs grows into a complex set of local regulations ultimately not achieving the original goal for which the same legislation has been originally designed.

In other words, **unless fixed costs (whatever their nature) are reduced significantly, no new regulation will be able to boost the international participation of SMEs on the Single Market**.

3.2. The extra-EU playing field

At the multilateral, global level, as long as 90 % of trade is concentrated in top firms, the role for small medium-sized enterprises as central policy actors is clearly limited. This is reflected in the scarce interest on SMEs in WTO negotiations. So far, only one initial negotiating proposal to the WTO, issued by Canada in 2001, has explicitly considered SMEs. The purpose of the proposal was to encourage in the negotiations consideration of barriers limiting the participation of SMEs in the global trade of services (see Box 2). However, the proposal has not been followed up by specific actions, pending the current state of play of the Doha Development Round.

Moreover, the same European Union, notwithstanding the strong drive towards SMEs in its internal market (see above), has never put small and medium-sized enterprises at the centre of its negotiating strategy within the World Trade Organization.

BOX 2: SMEs and the WTO: a proposal from Canada

In 2001 the delegation of Canada presented within the WTO negotiating Council for Trade in Services a proposal on SMEs' involvement ("Initial negotiating proposal on small and medium-sized enterprises", 14 March 2001, document S/CSS/W/49). The purpose of this proposal was to encourage consideration in these negotiations of barriers limiting the participation of SMEs in the global trade of services. We present here some extracts of the proposal:

Importance of service SMEs

The vast majority of service SMEs are realising new opportunities through applications of information technologies. Being on-line makes them automatically global. They are increasingly present in technology-intensive industries, such as information and communications technology, as well as in strategic business services, such as computer software and information processing or human resource development. However, the limited number of organizations to effectively voice SME concerns and the wide range of SME interests limits their capacity to defend their collective interests.

Internationalization of service SMEs

In an increasing integrated world, service SMEs will be more active in the global marketplace in order to maintain their job and wealth-creation capability. Advances in communication and information technology have given them potentially more efficient tools to operate internationally. They are making use of the Internet's competitive advantages of speed, convenience and reduced costs to enter new markets. To increase their participation in the international trade, service SMEs have to overcome barriers related to a discriminatory, burdensome and non-transparent regulatory environment. For example, onerous licensing, registration requirements and excessive user fees can create barriers that are particularly burdensome for SMEs. Smaller firms may also have less capacity to devote to activities related to entering and sustaining their activities in foreign markets as they often have less available capital and time than larger firms.

Due to limited resources, SMEs cannot necessarily respond as quickly and effectively to market access barriers as larger firms. The development of Mutual Recognition Agreements (MRAs) that will reduce these resources demands is very important for SME service providers. Members should consider ways to facilitate the development of MRAs.

Moreover, market access for service SMEs can be strongly hampered by a lack of information on regulatory regimes and requirements

Modes of supply

Due to their size and resource constraints, SMEs export services primarily by using mode 1 (cross-border) and mode 4 (movement of natural persons) because these are the least expensive and most effective ways for them to conduct business. However, many countries require businesses to establish a commercial presence before they will allow services to be imported into their market. This makes it very difficult for service SMEs to export to these markets because they cannot afford to establish a commercial presence in the foreign market. In order to help service SME exporters, in the negotiations, Members should explore ways to remove unwarranted mandatory commercial presence requirements on the cross-border supply of a service.

Electronic commerce may be a preferred vehicle of delivery for many service SMEs. To the extent that they establish a commercial presence in foreign markets, entry and exit barriers in foreign markets may be barriers to their effective participation.

However, in a joint declaration at the WTO Public Forum 2007, held in Geneva, Eurochambres and EuroCommerce, who jointly represent more than 20 million EU SMEs, stated the importance of multilateral agreement for SMEs. They declared together that a successful conclusion of the **WTO Doha Round** is particularly vital for SMEs because:

- dismantling trade barriers will enhance competitiveness across all regions, decrease the costs of living and increase consumer choice;
- simpler and harmonised customs procedures ("trade facilitation") will enable economic operators worldwide, and SMEs in particular, given the fixed costs problems previously highlighted, to save some 300 billion Euros per year;
- better market access for service providers will foster wealth and growth;
- improved multilateral rules, e.g. on antidumping, will provide for more predictability and legal certainty.

These issues are the more important the clearer is becoming our appraisal of the costs for SMEs associated to the alternative form of economic integration currently prevailing in absence of the Doha Round, that is **regional integration agreements**.

Since the Doha round was launched almost seven years ago, in fact, over 100 bilateral and regional deals have come into force, lowering tariffs for some members of the WTO, but not others, a phenomenon known as "regionalism" as opposed to the WTO "multilateralism". These preferential deals violate the WTO principle of the "most-favoured nation", which holds that any favour offered to one member must be offered to all, but are authorized within the same WTO under the provisions of art XXIV of the GATT Regulation[2]. The main problem of regionalism is that, in order to comply with art. XXIV and avoid a distortion of trade flows induced by the same agreements (the so-called "trade deflection"), regional integration agreements have to write and agree complex "**rules of origin**" in order to establish the nationality of the product and thus grant, only for those products whose nationality is comprised in the agreement, the exemption from the trade tariff.

Regionalism therefore entails large documentation costs, i.e. higher fixed costs for firms, at disadvantage of the usual suspect, SMEs. Empirical evidence shows in fact that, if the "most-

[2] When a WTO member enters into a regional integration agreement, through which it grants more favourable conditions to its partners in the agreement than to other WTO members, it departs from the guiding principles of non-discrimination (the most-favoured nation clause) at the basis of the WTO regulation. WTO members are however permitted to enter into such arrangements under specific conditions which are spelled out, among others, in Paragraphs 4 to 10 of Article XXIV of GATT (the original agreement on which the WTO is based). In this Article it is said that, if a free trade area or customs union is created, duties and other trade barriers should be reduced or removed on substantially all sectors of trade in the group. In any case, non-members should not find trade with the group any more restrictive than before the group was set up.

favoured nation" tariff is low enough, exporters will pay up the tariff, rather than trouble themselves with documenting the origin of their products. For example, only 5% of ASEAN trade takes advantage of preferential agreements, although these agreements have required painstakingly negotiations: South-East Asian companies, especially SMEs, are by and large not taking advantage of the ASEAN Free-Trade Area (AFTA).

Coherently with the "rule of origin" problem highlighted before, Eurochambres and EuroCommerce declare that in the unfortunate event of a failure of the WTO Doha Round, SMEs would face serious threats:

- there would be a 'spaghetti bowl' of Free Trade Areas, each with different rules of origin and individual customs procedures. In such an environment, SMEs would find it much more difficult to export and import – with obvious repercussions on earnings, job creation and the economy as a whole.
- SMEs could be obliged to manufacture different goods for different markets with a direct negative impact on their competitiveness – in the EU as well as in the developing countries.

Thus, all the evidence above points to the fact that **regionalism, as opposed to multilateralism, is likely to hinder the internationalization of SMEs**.

To counter this tendency, a recent trend is the emergence, at least in South-East Asia, of regional integration agreements that cover issues that go beyond the traditional FTA concept (Okamoto 2003). Such issues are often called "WTO Plus issues" or "new issues" because they typically lie outside WTO rules. These "new issues" relate to cooperation on science and technology (S&T), human resource development, the environment, and the very same focus on SMEs.

One example is the agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership (JSEPA). Going beyond tariff elimination in goods, JSEPA includes cooperation on a number of issues, among which is the promotion of SMEs in both countries. Another example is the Japan-Philippines economic partnership agreement (JPEPA), in which the two countries agreed to cooperate on improving the Philippines' legal system for competition policy, and support for SMEs in the Philippines. An analogous agreement takes place between Japan and Thailand (JTEPA). Again, the partnership aims also at promoting SMEs.

Capitalizing on this experience, it could be advisable for the EU to follow a similar approach when negotiating or revising the current network of regional agreements in which it takes place.

3.3. SMEs and specific trade issues

Similar problems are likely to arise when considering the issue of geographic indication and public procurement. Compliance cost are high, and may be a barrier to the entry in foreign markets. In this sense, some specific initiative are taking place to help SMEs overcome these difficulties.

In terms of **geographic indication**, for SMEs obtaining consumer recognition is extremely difficult. Gaining access to retail stores, local markets and distribution networks and making products known among consumers requires a significant investment that may exceed the budget of many firms. Given the small scale of production, many SMEs will find it difficult to develop a powerful marketing campaign that will enable them to position their products and create a reputation for their goods that will attract consumers.

There are several channels to overcome these difficulties. One opportunity is to create "collective marks" which enables SMEs to start joint marketing campaign for their products. Collective marks may provide a useful basis for association between various SMEs making similar products helping them to enhance recognition and build a reputation for their products.

Another possibility for SMEs is to coordinate their production over a territory and register their product as "geographical indication" if they consider that there is a clear link between their product and the geographical area where it was manufactured. This would guarantee exclusivity over the use of the geographical indication (e.g. "champagne" or "tequila") to promote their products.

Finally, they may use "certification marks" to certify that the product meets certain required standards thus giving consumers an indication that their product has been checked by an organization considered competent to certify the product and has met the necessary requirements. This too may help a company to market its products and improve its image among consumers.

All these issues, apart from the relevant WTO Council, are discussed within the World Intellectual Property Organization (WIPO), a specialized agency of the United Nations

dedicated to developing a balanced and accessible international intellectual property (IP) system. Box 3 discusses the activities of WIPO specifically dedicated at SMEs.

In terms of empirical evidence, Belletti et. al (2007) present a study on the impact of geographical indications (Protected Denomination of Origin (PDO) and Protected Geographical Indication (PGI)) on the internationalisation process of some small-medium scale agri - food products from Tuscany (Italy). Via open qualitative interviews they highlight the main motivations for the use of geographical indications on international markets. These could be both defensive (in particular defence from abuses in using geographical name), and offense against competitors (as in the case of product differentiation or exclusive right of benefiting from the reputation of origin). Besides, there is also a strictly commercial role in terms of giving an answer to the explicit request of certifications from customers.

Box 3. WIPO and SMEs

In 2000, WIPO Member States endorsed a proposal to establish a substantial new program of activities, focusing on the intellectual property-related needs of SMEs worldwide. WIPO's program of activities for SMEs aims to encourage a more effective use of the intellectual property system by SMEs worldwide. The main objectives of this program are to promote a more active and effective use of the intellectual property system by SMEs; strengthen the capacity of national governments to develop strategies, policies and programs to meet the intellectual property needs of SMEs and to provide comprehensive web-based information and basic advice on IP issues to SME support institutions worldwide. Some of the key activities of the SMEs Division include:

- Development of comprehensive and user-friendly promotional information materials, guides and training packages;
- Organization of training seminars for specific target audiences (in partnership with relevant international or national institutions);
- Research studies on issues relating to the business use of IP in various countries;
- Assistance to SME support institutions, such as innovation centers, incubators, chambers of commerce, R&D institutions and others to establish IP-related support services to their members and clients;

SME website with articles, case studies and best practices targeted to entrepreneurs;

Activities are conducted largely in partnership with organizations working to promote SME development at local, national and international levels in order to integrate intellectual property within a broader framework that addresses the multi-faceted business challenges faced by SMEs.

Geographical indications can be adopted as an internationalisation tool for SMEs, but their impact depends on several factors that rely on the characteristics of the product (vocation to export i.e. in terms of perishability, reputation, diffusion…), of the production system (rate of fragmentation, organisation, role of collective organisations…), of the firms (dimension, managerial capabilities, vocation to internationalisation), and on the characteristics of the

destination market (in terms of presence of trade barriers, availability of administrative and logistic support, consumer knowledge of the meaning and characteristics of the denominations…).

It thus follows that a less cumbersome legislation on geographical indications, while contributing to the general participation of SMEs in global markets, cannot be considered *per se* as a key driver of the internationalisation activity of SMEs, since other, more stringent conditions, have to be met in advance.

The latter finding is by and large in line with a common finding of the literature showing that the relationship between firm size and innovative activity is not straightforward and thus a more stringent **protection of intellectual property** should not in principle be more beneficial for SMEs when compared with larger firms.

The latter result derives from the fact that, while it is true that there may be economies of scale in R&D production and the innovative process, thus favoring such activities within large firms, the current consensus in the empirical literature is that this only holds consistently across different industries, characterized by different minimum efficient scales: within an industry, size does not matter. Moreover, it is argued that SMEs may have an advantage in innovation since they may have better information about the function that relates expected profitability of an innovation to development expenditure (Arrow 1983) and they may have less inertia than large firms (Rogers 2004).

Given these countervailing arguments, it is therefore not surprising that the empirical literature on the relationship between firm size and innovative activities is inconclusive. For example, Jensen and Webster (2004) estimate patent and trade mark rates per employee in Australia but do not find a significant difference between the large firm and SME sectors once industry effects are taken into account.

While these findings are there for the generality of cases, there are however specific situations which might call for a peculiar action in favor of SMEs. In particular, the European Union acts in favour of intellectual property rights of SMEs dealing with China, by means of the **China IPR SME Helpdesk**, which is a project funded by the European Commission, DG Enterprise and Industry. It introduces European SMEs to the knowledge and business tools required to develop the value of their intellectual property rights and to manage related risks. The Helpdesk provides free information, first-line advice and training support to European SMEs to protect and enforce their intellectual property rights in China. The Helpdesk provide also a range of practical training tools available in web-based forms and training workshops in Europe and China.

Another crucial issue which might affect the internationalization activities of SMEs, especially within the EU Single Market, is related to **public procurement**. The public procurement market in the EU, covering all levels of government and public agencies, is estimated to be worth around one-sixth of total GDP in the EU or about € 1,800 billion in 2006. Public procurement covers a wide range of supplies, services and works required by governments, local authorities and public organisations, utilities and agencies. The size of such contracts varies hugely. While some are clearly beyond the capabilities of SMEs to fulfill, a significant proportion of the public procurement opportunities in Europe are well within the scope of SMEs, and thus can act as important vehicles to stimulate cross-border activities of small and medium-sized firms.

However, the SMEs' access to public procurement varies from country to country. Overall in the year 2005 SMEs secured 42% of the value and 64% of the number of contracts above the thresholds fixed by the EU directives on public procurement. The directives cover roughly 16% of the EU public procurement market. Not surprisingly, medium-sized companies are performing better that small and micro companies.

Although SMEs are not specifically excluded from this market, the procedures and practices used in many tenders have the effect of disadvantaging SMEs over larger competitors. Typical obstacles for SMEs are difficulties in finding information about tenders, or about the procedures for bidding, or problems in understanding jargon. Deadlines for responding may be too short and/or the costs of responding are too high; the administrative procedures are too complex, or particular certification is required; a high financial guarantee is required to bid; or companies may face discrimination on the basis that they are located in a different country from the contracting authority.

In line with these findings, the European Council has underlined the importance of public procurement for SMEs' economic performance in the context of the Lisbon Strategy, calling for SME access to public procurement markets to be improved. To this extent, in 2004, the Council and Parliament adopted a package of directives on public procurement, (Directive 2004/17/EC coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors and Directive 2004/18/EC on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts) designed to reduce the administrative burden and costs related to tendering, make procurement systems more transparent and easier for SMEs to access, and encourage the use of information technology systems (e-procurement) to simplify the process.

These directives were due to be transposed into national law in all Member States by January 2006, but again, due to the uneven quality of transposition and the associated delays, it takes time before administrators adjust to the new rules and SMEs across Europe feel their full benefits.

To facilitate this process, the European Commission has proposed a **Code of best practices in opening public procurements to SMEs**, taken both from Member States and elsewhere. The Code encourages Member States to learn from each other as they implement the new rules under the public procurement directives.

In light of its direct impact on fixed costs, the latter seems to be a crucial area of attention to promote the internationalization activities of SMEs in the Single Market.

4. Policy actions to foster SMEs international involvement

4.1. Policy programs sustaining the internationalization of SMEs

So far, we have highlighted the problems and challenges that SMEs face in the internationalization process, together with an analysis of the main fixed costs (and their institutional and legal drivers) arising in the process. We now move to discuss some of the **policy solutions** elaborated to solve these problems.

A first caveat has to be kept in mind: as a general rule, the market should provide the most efficient method of allocating resources. Therefore, the Government's main role should be to facilitate the effective functioning of markets by providing a stable macroeconomic framework, effective institutions (a framework of corporate governance and commercial law, enforcement of contracts…) and, at the micro level, supply-side flexibility. These tasks should be enough to keep governments busy, nonetheless market have their limits: if the assumptions under which free markets lead to Pareto-optimal outcomes are not met, there is a case for government intervention to address these market failures.

The latter might be especially true in light of the recent **financial crisis** hitting the world markets: if not adequately dealt with by coordinated government interventions, the crisis might dry up credit especially for firms less able to provide adequate collateral, i.e. SMEs, with important consequences for their investment and even day-to-day strategies. To this extent, the decision by the EIB to set aside a special line of credit for European SMEs for a total of 30 billion Euros is mostly welcome, but might not be sufficient. A continuous

monitoring of the situation by national government, in strict coordination with the EU Institutions, is therefore necessary.

In terms of government intervention aimed at fostering internationalization activities of SMEs, there are a number of market failures that can limit the firms' willingness to export and can thus be appropriately dealt with by economic policy.

Imperfect or **asymmetric information** may lead to sub-optimal exporting activity, in that inexperienced exporters may underestimate the uncertain benefits of exporting and so, when facing the cost of entering export markets, may decide not to risk. The public good nature of some information suggests that the market may not provide it in sufficient quantities, and thus a public intervention could be welcomed. Another example is the **access to networks**, which are regarded as an important channel for knowledge transmission. In geographically and culturally distant markets, firms may lack access to such networks, and the private sector alone may not be willing to develop or support networks: again in this case there is a rationale for public intervention. Moreover, export activity generally entails **search costs**, which derive from the need to identify potential trading partners and assessing their reliability and trustworthiness. These costs are larger when economic opportunities are geographically dispersed.

To deal with all these issues, **export promotion agencies** have been created in order to help firms overcome difficulties related to the export activity. These agencies take a number of actions in order to help exporting firms. For example, they provide training on the export process, marketing, and business negotiations. They offer country and product market studies and provide specific information on trade opportunities abroad. They support firms' participation in international trade missions and trade shows. Finally, they organize trade shows and fairs and sponsor the creation of consortia of firms aiming at strengthening their competitive position in external markets.

Volpe and Carballo (2008) provide evidence on the impact of export promotion activities performed by PROMPEX, Peru's national export promotion agency, on firms' trade over the period 2001–2005 using a unique dataset including information on exports by product and destination market. PROMPEX trains inexperienced exporters on the export process, marketing, and business negotiations; performs and disseminates analyses on country and product market trends; provides specific information on trade opportunities abroad as well as specialized counseling and technical assistance on how to take advantage of these opportunities; coordinates and supports (and in some cases co-finances) firms' participation in international trade missions and trade shows, and arranges meetings with potential foreign

buyers in particular; organizes these kinds of trade events; and sponsors the creation of consortia of firms aiming at strengthening their competitive position in external markets. These activities performed by PROMPEX are likely to alleviate the previously discussed information problems that affect exporters. The authors however find that export promotion activities are mainly associated with larger exports, which increase on the extensive margin, while there is no impact on the intensive margin. In other words, export promotion increases exports through an increase in the number of products exported, or the number of foreign markets reached by domestic firms, while it does not affect the intensity of trade for a given product in a given market. As such, at least in the case of PROMPEX, these activities risk favoring already established, large exporters.

To counter these problems, export promotion programmes may be directly targeted for SMEs. For example, Romania implemented a national program for supporting SMEs in export activity. The program aims are the promotion of SMEs products and services into foreign markets; stimulation of communication and business partnership into foreign markets; training of entrepreneurs in the area of export promotion techniques; improving the access of SMEs to market information.

An interesting example of cooperation between different countries is the EMPRETEC Program, a joint effort from Romanian National Agency for SMEs, UNCTAD, and Ministry of Productive Activities from Lombardy. This program aims at supporting entrepreneurs from Romanian economic environment, trough international marketing and export courses.

Another example is the "Small and Medium-Sized Enterprise Promotion Programme" promoted by German Federal Ministry for Economic Cooperation and Development (BMZ) in Egypt. In this case, training and consultancy services are developed together with SMEs in close cooperation with associations and other private sector organisations. The programme supports the entire value chain in the different sectors i.e. all the stages a product undergoes from conception through to the final consumer. Technology transfer plays an important role. Innovation centres, associations, and consulting firms are supported in building up their own consultation competencies and capacities, enabling them to directly offer the services required by the SMEs. One of the services being developed, for example, is a business intelligence solution which will provide information in a simple and concise format on international trade agreements, trade policy as well as market and sector information.

Denmark has an internet portal for SMEs (www.smv-portalen.dk) where companies can self-assess their readiness to export. A number of export consultants are available to assist, free of charge, in working out export action plans and provide various export advice.

Notwithstanding these programs, and the considerable efforts and resources devoted into them, **export promotion is not always effective**, and a lot of caution must be taken in the choice of policies to be implemented.

Nowadays, the literature allows in fact for a fairly thorough assessment of the impact of export promotion policies on export performance, and the results are not clear-cut. Bernard and Jensen (2004) consider export promotion activities on a sample of 13,550 US manufacturing plants for the period 1984-1992. They find that average state expenditures on export promotion per firm do not have a significant influence on the probability of exporting. More recently, Görg et al. (2008) analyze a sample of around 600 manufacturing firms per year in a European country, Ireland, over the period 1983–2002. They find that grants aiming at increasing investment in technology, training, and physical capital, when large enough, are effective in increasing total exports of already exporting firms. Nonetheless, these grants do not encourage new firms to enter international markets.

While grants for investment in technology, training, and physical capital, or training itself proved to be effective, the results in the case of **trade missions** are ambiguous. Graham (2001) for example notes how persistent is the (often wrong) notion that merely bringing business people together will result in business deals. There are many complicated factors that go into making a buying decision or closing a business deal across national borders; therefore it is not very realistic to assume that merely bringing the parties together in the same physical space will overcome these other very important issues. He notes also that trade missions sponsored by industry organization are more successful than those sponsored by government agencies. Trade missions sponsored by private industry groups tend to pick venues and choose local partners who have the necessary expertise to produce successful events. Industry organizations represent the industry and are not beholden to other private political interests. When government agencies become involved, instead, the actual reason for doing the trade mission may have nothing at all to do with the particular industry selected or the actual companies selected to participate.

To provide scientific evidence to these claims, Rose (2005) employs a gravity specification to investigate the effects of foreign missions (embassies and consulates) on trade. Based on 2002-2003 export data of 22 exporters and 200 destination countries, he finds estimates that an initial consulate or embassy is associated with a more than 100% increase in trade whereas each subsequent foreign missions adds 6-10% to trade. Nitsch (2005) investigates the trade effects of visits by heads of state of France, Germany and the United States between 1948 and 2003. He finds the visits are associated with a 8-10% increase in exports using a standard

gravity specification and a specification where visits affect the growth rate of trade. Gil-Pareja, Llorca-Vivero, and Martinez Serrano (2005) closely follow the Rose approach to investigate the export promotion agencies of Spanish regional governments. Using a panel of exports of 17 Spanish regions to 188 countries for the period, 1995-2003 and controlling for standard gravity model variables and the number of embassies and consulates, they find that regional agencies increase exports by over 50%.

Head and Ries (2006) consider Canadian trade missions, which are of two types. Team Canada Trade Missions are led by the Prime Minister accompanied by provincial premiers whereas Canada Trade Missions are headed by the Minister of International Trade. Other government officials and Canadian businesses participate in the missions. The objectives of the missions are "to increase trade and investment, as well as create jobs and growth in Canada. They help build prestige and credibility for Canada, while helping exporters to position themselves in foreign markets." (http://www.tcm-mec.gc.ca/ctm-en.asp).

Team Canada Trade Missions are larger and of longer duration than Canada Trade Missions, with the former averaging over 300 businesses participating compared to typically less than 100 for latter. Business deals are in the form of contracts, memoranda of understanding, and letters of intent. They involve merchandise and service trade agreements as well as joint venture agreements and other types of investments. The authors correctly observe that trade missions create trade if trade is higher after a mission relative to what it would have been in the absence of the mission. The key in the analysis is generating a "control" with which to compare Canadian trade performance with mission countries. Two control groups are considered: 1) Canadian trade to nontarget countries; and 2) trade performance of third-countries with mission countries. They use Direction of Trade Statistics from the OECD and consider trade among 160 countries form 1990–2003.

They observe that, while Canadian exports to target countries increased on average after the missions, consistently with the previous results, this increase was not larger than Canadian exports growth to other countries and resto of the World (ROW) exports to target countries. Using a gravity model they find that Canada Trade missions do not have a significant relationship to exports. Moreover, looking at trade growth after trade missions, they find that the mission did not increase trade once they control for Canadian trade levels with mission countries before the mission.

4.2. Suggested policy actions

The general evidence on exporting firms has shown that efficiency gains from exporting seem to accrue only to medium and large new exporters, due to the presence of relevant fixed costs in the exporting activity. The surveyed policies on the status of SMEs in international trade practices have also shown that fixed costs are likely to persist in the future, due to the increasing complexity of international trade operations, and the lack of a systematic policy related to SMEs within the multilateral negotiating framework. Even within a regional approach to economic integration (regionalism), the existence of significant costs of implementation in the rules of origin act as an important obstacle for the access of SMEs to the integrating area, as shown by the South-East Asian experience.

Some proposals specifically related to SMEs start being discussed in international fora (specific provisions for SMEs within FTAs, or a special clause on SMEs needs within the WTO negotiations), but practical actions are still lacking. The same discussed changes to provisions on geographical indications of products or public procurement do not seem to be specifically centred on the needs of SMEs, and thus are not likely to significantly foster their involvement in international trade activities.

Hence, lacking over the short run a systemic reduction of fixed costs for SMEs within the working of international markets, Government are increasingly resolved to tackle the problems by directly intervening in favor of SMEs, trying to reduce the fixed costs of their international involvement via a number of export promotion policies surveyed above. However, the results of these policy actions are not clear-cut, with mixed results obtained in terms of effective support for the internationalization of SMEs.

Therefore, in an economic environment characterized by a traditional scarcity of available resources, **export promotion policies do not seem to be the most efficient way to foster the active participation of SMEs in international markets**.

Moreover, even provided that successful export promotion policies can be designed, leading to an actual boost of exports of SMEs, as it has recently been the case with the UK Trade and Investment promotion organization (see Alexander and Warwick, 2007), we cannot be sure of the overall **welfare effects** of these promotion policies. According to the theory and the available empirical evidence, in fact, only the most productive firms (which also tend to be relatively large) will tend to export, since only these firms, thanks to their superior efficiency, find convenient to pay the fixed costs of exporting. Now, by introducing a de-facto subsidy to the export activity in favor of SMEs, we would be allowing to export firms which, given their

own productivity level, would not be able to participate ex-ante to international markets. As a result, we would be introducing a distortive measure, which favors less productive firms, while at the same time harming the allocation of economic activity towards the more productive ones, with a net loss for the overall productivity of the country (since the more productive firms would end up having a lower share of economic activity). Such a policy action goes against the goals of the Lisbon agenda.

A more efficient, and less distortive, way of supporting the internationalization of SMEs, instead, would try to affect the exporting status indirectly, through measure aimed at **increasing productivity** of SMEs. Once SMEs reach a high enough productivity threshold (presumably correlated with some dimensional increase in their activity) they will be able to afford the fixed costs of exporting and will 'naturally' become exporters.

To this extent, several policy measures, all directly related to the export-productivity link, can then be suggested. In particular, empirical evidence shows that product innovation is important to dress up for exporting, and process innovation becomes important at a later stage when volumes of exports increase sufficiently. Therefore, **to promote exports for SMEs in a manner compatible with the Lisbon objectives, we should first promote innovation**. To this extent, a number of policy actions can be suggested:

- First, a general scheme for the promotion of innovation: this could be implemented through R&D subsidies, tax credits for R&D expenditures, sector-specific schemes, and SMEs-specific schemes.
- Second, a scheme for the promotion of entrepreneurship: encouraging innovators to become entrepreneurs via the promotion of venture capital financing and the actual implementation of the "think small first" principle.
- Third, a scheme for the promotion of knowledge transfer between universities and business (financing of projects applied for by the firms in cooperation with universities) and finally a promotion of establishing high-tech companies (technological parks, incubators at the universities…).
- Fourth, policy actions aimed at fostering also technology adoption, in addition to technology development: a growing evidence exists in fact that import penetration positively matters for the productivity of domestic firms, with the larger effect deriving from the imports of high-quality intermediate products.

All these actions should take place within a Single Market in which the principle underlying the Small Business Act are thoroughly implemented, since the latter will help SMEs to

increase their productivity by removing a number of constraints, structurally reduce their fixed costs of operating and, ultimately, as an outcome and not as a goal *per se*, promote their participation on the international markets.

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