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"The Logic of Zero": Boosting SMEs Trade in TTIP

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The Transatlantic Trade and Investment Partnership (TTIP) has several novelties. One is that it will include, for the first time in a free trade agreement, a separate chapter dedicated to the internationalization of small and medium sized enterprise (SMEs). Boosting SME participation in trade is key to reap the full potential of new trade agreements. However, for SMEs to expand their trade participation, small and gradual reductions of trade barriers are not enough. Facing various types of barriers to trade, including natural ones, they rather need policy-based trade barriers and the ensuing artificial transaction costs of trade to be eliminated.

The trade benefits from TTIP can be significant, but not necessarily for SMEs. For many SMEs it takes courage to step out of their domestic markets and start exporting. With their resource constraints and the risks associated with getting into a foreign market, a large number of SMEs argues it is not worth it. Trade, for sure, might open up new opportunities to prosper, but for those without any experience in foreign trade, the potential losses can break the financial backbone of the company. There are natural barriers to trade such as language barriers or currency risks. But there are also policy barriers – the main barrier being the cost of complying with all relevant trade regulations. Reducing these regulatory barriers is key for trade policy to boost SME trade. Yet, in contrast to the trade of many multinationals, small and progressive reduction of such barriers will most likely not yield faster trade expansion by SMEs. In order to facilitate trade for SMEs, barriers to trade would rather have to be eliminated.

Due to their limited resources, SMEs do not exploit trade opportunities as much as desired. Firstly, they face high barriers to entry when targeting foreign markets. Lack of knowledge of the market and consumer taste, stiff competition, high fixed and sunk costs often restrain SMEs from internationalization. Secondly, lack of human and physical resources necessary to overcome barriers to trade refrains SMEs from exporting abroad.

In the European Union, a large number of small and medium sized enterprises operate in their domestic markets and only 25% of SMEs export, of which half within the Single Market and half outside the Single Market. The most important trade partners are other European countries, the United States and emerging markets in Asia. According to a survey by the European Commission, about 75% of SMEs does not consider the possibility to grow internationally through export.

Although the U.S. is one of Europe's most important trade partners, SMEs, and other types of firms too, are facing high barriers to trade. Since the EU and the U.S. are members of the World Trade Organisation (WTO), progressive tariff reductions have taken average tariffs into low territories. Tariffs are still a problem, however for some products they are still high, but even when tariffs are low they create an administrative burden and are a nuisance. Non-tariff barriers (NTBs) remain high across the board, and the big benefit of TTIP would come from reducing or eliminating NTBs. This is also true for SMEs: the main obstacle for SMEs to internationalise is the cost and risk associated with administration and regulation.

The European Commission recently surveyed 869 European SMEs about which barriers they meet when exporting to the United States. Mainly four sectors were analyzed in the report: food and beverages, pharmaceutical and chemicals, textiles, computer and electronics. Unsurprisingly, the report reveals that most of the trade barriers faced by SMEs are related to typical NTBs for those sectors such as sanitary and phytosanitary measures (SPS) and technical barriers to trade. In the food and beverages and agricultural products industry, 40 respondents stated that they need too many and too costly authorizations, certifications and inspections in order to enter the American market. As a result of regulatory costs, some producers said they avoided the U.S. market completely. That is the logic of zero: if costs and risks are too high, many SMEs do not just trade less; they do not trade at all.

In the pharmaceutical sector, SMEs face similar obstacles. A large German firm noted that EU firms are subject to both American and European controls, claiming that mutual recognition of Good Manufacturing Practices (GMP) standards and monitoring between the EU and the U.S. would facilitate the movement of drugs and their active ingredients. Although complaints about tariffs are reported less often, they still have an effect on trade. A small producer from the U.K. stated that negotiations with a U.S. retailer broke down due to the complexity of stamp duties and taxes to be paid to export to the U.S.

What can TTIP do for small and medium sized enterprises then? Besides lowering tariffs and non-tariff barriers (NTBs), TTIP can create solid market advantages for SMEs. It can open new markets for goods and services, increase opportunities for investment, make trade cheaper by cutting customs duties and red tape, speed up trade by making customs clearance easier and setting compatible technical and sanitary standards, create greater certainty through clear rules on intellectual property rights, competition and public procurement.

TTIP is often referred to as being a new type of trade agreement, where reforming the trade regulatory framework is perceived to be more important than cutting tariffs. As mutual recognition between 28 Member States in the EU ensured that national technical regulations do not constitute barriers to free trade, the same can be achieved between the U.S. and the EU. A product lawfully produced or marketed in one EU country could be marketed in the U.S. Accepted standards by the U.S. and the EU can stipulate technical or quality criteria for products, services and production processes. Mutual recognition cuts off distortions in the market such as burdensome paper work and extra costs set up by regulations which decreases the final profits coming from trading.

Ideally TTIP should strive to create a trade environment similar to the single market in Europe, where tariffs are zero and non-tariff barriers considerably lower than in international trade. Every company in the EU has access to 28 national markets and 500 million potential customers. Intra EU trade increased notably since the creation of the Single Market. Intra-EU export increased from 1,5 trillion in 1999 to 2,9 trillion in 2014. Similarly, Intra-EU import increased from 1,4 trillion in 1999 to more than 2,8 in 2014 (Eurostat).

This is an ideal – and it is perfectly obvious from the negotiations so far that both sides have climbed down from the high ambition when the talks were launched. But a low-ambition trade deal on NTBs will not give a necessary boost to SME trade. Adding an extra chapter in the Transatlantic Trade and Investment Partnership exclusively dedicated to small and medium sized enterprises will not help much if it is not backed up by significant reductions in the artificial transaction costs of trade. And you would think that such an ambition would be stronger in Europe than in the United States. While SMEs are the backbone of the U.S. economy too, Europe is unique among advanced economies for its high reliance on SMEs. SMEs represent 99% of the businesses in Europe, contributing annually to roughly one third of GDP. Their importance cannot be ignored – and trade policy needs to better reflect their character and propensity to engage in cross-border exchange.