SMEs: how to integrate them into the international trade framework?

“Case for the Model WTO 2017”

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This case study, will be the basis for the negotiations which will take place in the Model WTO 2017 in its 20th Edition.

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# Table of Contents

Foreword and Acknowledgements.................................................................................................................. 3

Small and Medium Enterprises (SMEs) ............................................................................................................. 4

1. Committee on SMEs Development: ............................................................................................................. 5

2. Committee on SMEs and Non-Tariff barriers (NTBs) .................................................................................. 7

3. Committee on SMEs and E-commerce ......................................................................................................... 9

4. Committee on SMEs and Trade in Services ............................................................................................... 11

5. Committee on SMEs and Subsidies ............................................................................................................. 12

6. Committee on SMEs and dispute settlement: ............................................................................................. 13

References ......................................................................................................................................................... 14
Foreword and Acknowledgements

SMEs have been largely absent from the trade debate in the past despite accounting for the majority of firms in most countries. This had several reasons: their participation in trade is relatively weak, they are mostly unable to exploit economies of scale and are therefore less productive. Besides this Non-tariff barriers and further obstacles impede SMEs’ participation in trade stronger than large firms’ participation.

However, through technological progress, e-commerce and increasing global value chains, new opportunities are opening for SMEs. Consequently, there has been a rise in awareness for SMEs in the last few years through their inclusion in regional trade agreements. In addition, the world trade report 2016 on the topic of “Levelling the trading field for SMEs” increased the recognition further. As the importance of the topic developed while no actual measurements have been taken so far, it is time to discuss “How to integrate SMEs into the international trade framework” in more depth.

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“The Model WTO 2017 organising team welcomes you to the simulation and encourages you to engage in fruitful discussions about the topic.”
Small and Medium Enterprises (SMEs)

“Micro firms and SMEs account for the majority of firms in most countries (95 per cent on average), and for the vast majority of jobs” (World Trade Organization, 2016, p. 3). Yet, trade liberalization rhetoric has not included the debate on SMEs on a large scale until now. Besides some regional agreements, the facilitation of international trade for SMEs is a challenge to be faced. Due to the fact that efficiency gains from international trade are generally only enjoyed by bigger players in the market, there has been criticism on the rule setting which is influenced majorly by these (Altomonte, 2008, p. 3). SMEs have therefore not been taken into account to the extent that they should be, considering their importance. Taking the previous into consideration, the World Trade Report released by the World Trade Organization in 2016 addresses the issues that Small and Medium Enterprises face. This report further comments that “SME participation in trade is neither well documented nor well understood”. This of course, creates trouble for policy-makers which would like to address this issue. Nonetheless, as international trade regulations have evolved and stabilized over time, the dialogue about involving SMEs in these rules has increased.

It is in the interest of the WTO to start discussion on this topic within the next few years (World Trade Organization, 2016). In general, the World trade report proposes 3 different approaches to increase the participation of SMEs in the international trade framework:

1. Decreasing the fixed costs of trade: Such measures can be achieved by encouraging State subsidies for SMEs which want to trade abroad or by encouraging countries to further reduce Technical Barriers to Trade (TBTs).
2. Decreasing the variable costs of trade: expand and increase quota and duty free market access to developing countries and maybe implement preferential treatment for SMEs for which however a clear definition is needed.
3. Increasing transparency and information access to the markets by means of online platforms and nation-wide information databases.

Taking these aspects into account and establishing international rules however, is not as easy as it may seem. One of the reasons, is that many of the existing trade barriers exist no to actively restrict trade, but because of national interests like health (through health standards), security (through data sharing limitations) and development (through other technical barriers to trade).

In the Model WTO 2017 edition, participants will be tasked with discussing and negotiating the development and creation of new or existing regulations, to adapt current international trade rules to SME needs (if necessary). This shall be done within one of the 6 committees which have been set up on the basis of the most relevant issues for SMEs discussed by current scholars and WTO experts.
1. Committee on SMEs Development:

Although there is no commonly agreed definition of a micro firm, the majority of countries define them as firms with up to 10 employees. Micro firms and SMEs account for more than 95% of all enterprises in OECD countries. It is a very important topic as it is one of the United Nations’ Sustainable Development Goals to reduce poverty in developing counties through MSMEs.

In the nineteenth and twentieth century, scale was often the reason for success in international trade because of high transportation costs, communication and border costs. In recent years however, there have been big changes due to international trade global communication networks and diminishing advantages of scale. Drastic lower trade costs have led to different circumstances. MSMEs companies benefit more from market liberalization and policy coordination including non-traffic measures than larger firms. In addition, rapid innovation and organizational flexibility present an advantage for small companies in the fast-changing markets.

For MSMEs to prosper, it is important that trade barriers across countries are reduced. Improved transportation, telecommunication links and breakthroughs in information technologies are also adapted rapidly in their frameworks which allow them the easier entrance into international markets. Therefore, developments in information technologies allow easier entrance and ultimately lead to bigger international competition.

Some of the least developed countries and the developing countries have proposed special treatment for SMEs within the international trade framework, but up until now, no concrete measures have been taken. Special treatment for SMEs like national funds or eased technical assistance could promote the entrance of MSMEs in the international framework even further. However, it has been debated and mentioned that MSMEs in developing countries do not have equal opportunities even though they provide for most of the jobs in these countries. The 2016 edition of the World Trade Report already shows that this problem has been spotted and proposes that this topic might be up for discussion in following years (World Trade Organization, 2016).

Implementing special and differential treatment for such enterprises, has also been seen as an implementation of further market barriers, and therefore contrary to WTO goals. However sister organizations which are supported or even supervised by the WTO like the Aid for Trade initiative with its EIF (Enhanced Integrated Framework) (which works together with the World Bank and the IMF), and the International Trade Centre, have managed to start projects of aid to MSMEs through private funding. Such projects could be developed or even further integrated into the WTO framework.

The committee on Trade and Development shall discuss possible inclusions of clauses of special and differential treatment for MSMEs, either into the existing agreements (modifying and amending existent agreements of the WTO like the GATT, GATS, GPA, etc.) or in the form of a completely separated and
new agreement (which not necessarily has to have the participation of all WTO members. Such agreement should include if necessary clauses on the definition of MSMEs, creation of working groups or investigation groups or the creation of projects which encourage the participation of these companies in the international trade framework. This shall be done without violating any existing rules (except if they are amended) and taking into consideration basic principles like non-discrimination. Furthermore, the rules shall not contradict those which are discussed in the other committees.

At last, other questions that can be discussed are: How can MSMEs be better integrated into the international trade law rulemaking to take their needs better into account? Should special and differential treatment apply for all or only for MSMEs in LDCs or with other pre-requisites for example? Does the implementation of such rules require further investigation and research?
2. Committee on SMEs and Non-Tariff barriers (NTBs)

Non-Tariff barriers (NTBs) refer to “quotas, import licensing systems, sanitary regulations, prohibitions” (The World Trade Organisation) and are impediments to trade, especially for Small and Medium Sized Enterprises (SMEs) (Fliess & Busquets, 2006, p. 1)

According to a OECS/APEC survey SMEs are mainly restricted in their international trade by unfavorable foreign rules and regulations, high tariff barriers and inadequate property rights protection. High costs of customs administration and restrictive health, safety and technical standards are further restrictions. The survey states that SMEs are less effected by arbitrary tariff classification and unfavorable quotas or embargos. However, the significance of certain restrictions depends on the level of internationalization and the SMEs’ market. (Fliess & Busquets, 2006, pp. 5-7). Procedural barriers to trade influence the market further through market access although being indirect and less visible.

Due to a lower productivity, SMEs are lacking economies of scale and have limited resources to access the international market in the first place (Klimek, 2015, pp. 55-56). Furthermore, financial and human resource constraints restrict SMEs caused by absent knowledge about regulatory frameworks domestically and abroad. Furthermore, SMEs are reluctant to engage in trade due to a lack of interest as they experience a biased market towards larger firms and due to a lack of advocacy expertise resulting in the inability to develop strategies. (Fliess & Busquets, 2006, p. 12)

In the General Agreement on Trade and Tariffs (GATT), the WTO has taken first steps to reduce tariff and non-tariff barriers in order to improve free trade. Agreements like the Information Technology Agreement (ITA) in 1996 aim to reduce tariffs on IT products completely (Information Technology Agreement). Nonetheless, NTBs still remained present after the agreement. Consequently, the WTO has initiated the Technical Barriers to Trade agreement which is binding for all WTO members and which entered into force on the 1st of January 1995. It “aims to ensure that regulations, standards, testing and certification procedures do not create unnecessary obstacles to trade” (Technical Barriers to Trade, p. 7). The TBT agreement is related to all products, industrial and agricultural as written in Art. 1.3 of the agreement. The TBT agreement tries to “balance between upholding legitimate regulatory policy objectives and respecting the key disciplines of multilateral trade under WTO rules, including avoiding the creation of unnecessary obstacles to international trade” (Technical Barriers to Trade, p. 11). This is significant as certain health and quality standards should be valid for all goods not depending on the country of origin or responsible enterprise.

However, the TBT agreement offers voluntary standards (for common and repeated use, guidelines for methods and production processes) and mandatory technical regulations (about product characteristics, processes or production methods as well as applicable administrative provisions. Furthermore, specific
conformity assessment procedures (direct or indirect procedure to determine fulfillment of technical regulations and standards) are explained. (Technical Barriers to Trade, p. 13)

The conformity assessment procedures (CAP) include procedures for sampling, testing and inspection; evaluation, verification and assurance of conformity; registration, accreditation and approval as well as their combination (TBT, Annex 1.3). It is mainly mentioned in art. 5-9 and Annex 1.3 of the agreement. The agreement further strongly encourages members to apply “relevant international standards, guides or recommendations as a basis for their regulations and standards Art. 2.4, 5.4 and Annex 3, paragraph F” (Technical Barriers to Trade, p. 20) but it is the decision of the member if the application of a standard is useful in specific cases (Technical Barriers to Trade, p. 21). Those standards are supported as technical requirements vary from market to market and trader have high costs for the adaptation and conformity assessment hindering competition and international trade which can be overcome through common standards.

The principles in the TBT Agreement are “non-discrimination, avoidance of unnecessary barriers to trade, the use of international standards, […] technical assistance and special and differential treatment for developing countries [and] transparency” (Technical Barriers to Trade, S. 15). The principles apply to the previous established categories: for example, the non-discrimination article can be found in art. 2.1 for technical regulations, art. 5.1 and 5.11 for conformity assessment procedures and in Annex 3 para. D for standards.

This committee shall discuss on the significance of NTBs for SMEs and find solutions to reduce the burden for them and ways to integrate them better in international trade. Doing so, special attention shall be given to TBTs and the TBT Agreement. A discussion about the existing principles of the TBT Agreement, the consequences of the principles for SMEs and potential changes in favor of SMEs are encouraged. The CAP shall be discussed as well, along with ideas how to involve SMEs further in the processes. The involvement of SMEs in the standard setting shall be evaluated in detail to improve SMEs ability to engage in international trade.

Besides this, debates about programs to assist SMEs to overcome information and experience barriers should be discussed along with an investigation of public consultation processes. A debate about financial aid and investment programs for SMEs will also be appreciated.
3. Committee on SMEs and E-commerce

E-commerce is defined as the buying and selling products and services through an electronic medium, such as the Internet. In fact, the distinction between Sales (e-sales) and Purchase (e-purchase) helps to define E-commerce.

E-commerce lowers the cost of buyers and sellers, as it eliminates time and spatial limitations as well as transaction intermediaries. Thus, this allows E-commerce to overcome some trade barrier and as a result allows easier access to global trade markets for SMEs at lower costs. It is a huge opportunity for SMEs and MSMEs to take part in international trade. However, until recent years, this was only possible for large firms, as it they possess more resources to use in the required bureaucracy. Hence, through the creation and development of new e-trading platforms, new opportunities have arisen for SMEs. By having access to worldwide markets, these companies have the possibility to sell in larger quantities abroad. Moreover, this not only gives the possibility to increase their return on scale, but also enhance their competitiveness. The benefits from e-platforms are not limited to trading but also include exchange of information and data transfer.

The major challenges that SMEs face within the realm of E-commerce, are regulations in the legal environment, infrastructure (logistics, shipping of goods, delivery service), lack of IT skills (especially in LDCs), security and data protection. Additionally, logistic and infrastructure costs, regulatory uncertainty, and access to skilled labor make the environment even more challenging. Also, the lack of awareness and unavailability of funds, as well as, local restrictions on the international transfer of funds, reduce their access to growth possibilities. Moreover, international payment platforms like PayPal are often not used as these don’t always operate globally.

Furthermore, the shipping price and streamline costs are quite high. The minimum of compulsory inspections varies within one’s country and depending on the product. They can vary from 70 to 300 dollars, which makes cross-border trading more complicated and unclear. Institutions like the world’s custom organization tries to break down the shipping costs and ease this process, but such efforts are not enough. These factors discourage SMEs from engaging in international trade.

New advancements in Information Technology like digital signatures, or the internationalization of banking payment systems, are factors that are and will continue to ease SME integration.

Currently the WTO has the E-commerce Facilitation Agreement which has allowed Members to make international transactions with very low to none transaction costs. However, this agreement was only implemented for a limited duration, and has been extended 3 times already. Several member countries have asked the WTO to make e-trade facilitation agreement permanent.
Currently a digital chasm exists between developed countries, developing countries and LDCs in areas of regulations on cyber security and internet payment systems. Therefore, it is in the interest of the WTO to tackle this problem by encouraging countries to develop such regulations, as well as standardize them across borders (as far as possible). The topic of E-commerce has been put on the list of topics that might be discussed at the Ministerial conference in Buenos Aires 2017 and shows the willingness of members to start discussions about possible regulations in these areas.

In our negotiations, you shall discuss the implications of E-commerce on globalization and for the domestic markets as well as possible regulation standardization and implementation within the existing international trade legal system. This can be done in the form of a new agreement (Information and Technology Agreement) or as amendments to existing agreements. Questions that might come up in the discussions are: Does E-Commerce minimize the gap between developed and developing economies? How can the WTO increase or ensure bigger efforts from the members, to develop the access to the internet and its resources for SMEs specifically?
4. Committee on SMEs and Trade in Services

As part of the GATS agreement, regulations for the international trade in services were divided into 4 different modes of supplies. These represent the different forms in which services can be traded across countries. The modes of supply regulate all international trade and therefore directly affect cross-border trade for SMEs. According to the World Trade Report of 2016 and Persin (2011), SMEs are primarily affected by regulations in Mode 1 and Mode 4 of supply. This is principally due to size constraints. While mode 1 regulates cross-border trade, mode 4 regulates the movement of natural persons across borders.

Mode 1 presents great possibilities for SMEs. With the expansion and fortification of the global e-commerce framework, SMEs have and are getting more and more possibilities to access international markets within the service industry. E-commerce regulation and access options especially for developing and least developing countries is limited or non-existent. A big problem of the GATS however and especially for mode 1 of supply, is that there are not many binding regulations. On top of that, many sectors are excluded within the agreements of accession of many countries. The question is then: How can countries be further encouraged to regulate on this topic?

The second main challenge within the SME framework, is the mutual recognition of licenses and qualifications. This falls under the realm of mode 4 of supply. Although this is a problem that all companies face, SMEs are more affected by it. This especially because of the low credibility foreign SMEs have with the institutions or orders (like the order of architects) which are in charge of the recognition after the government has delegated these tasks. Some regional trade agreements (RTAs) already provide first steps to mutual recognition of qualifications but on an international basis, the Annex on the movement of natural persons of the GATS agreement, is the only binding agreement. (WTO, 1995; Carzaniga, 2016)

As part of the committee on the trade in services, you shall discuss the problems that SMEs face regarding mode 4 of supply and cooperate together with the committee on e-commerce to solve and propose regulations for mode 1 of supply within the GATS agreement. The main questions that you should be discussing are: How can regulations be implemented or countries be encouraged to create more mutual recognition agreements? Is this possible on an international scale? How can SMEs be involved more in the regulation making process to be incentivized to participate in international trade?
5. Committee on SMEs and Subsidies

One of the current limitations of providing subsidies for legal fees or procedures for SMEs to enter with more ease in the international trade framework is the existing WTO agreement on subsidies and countervailing measures. The Agreement follows a traffic light approach for subsidies. While “red-light” or prohibited subsidies represent those industries where the latter shall not be allowed under any circumstances, actionable and non-actionable subsidies (“orange and green-light” subsidies respectively) are those in which member countries can under certain circumstances implement subsidies but such measures can be disputed or questioned by other member parties through consultation or dispute settlement. (WTO, 2003; Bigdeli, 2011)

Developments in the last few years, have made non-actionable subsidies completely disappear and actionable subsidies almost be reduced to extinction. However, the “reintroduction” or “revival” of such could prove useful especially for small and medium enterprises which due to their relatively small size (compared to big corporations) and smaller income, cannot afford entrance into international trade and even less to international disputes (Bigdeli, 2011). One of the major question for subsidies is: Can capital support which is provided to SMEs of a country in general really be considered a subsidy? Article 2 of the SCM agreement could provide the answer for this (Mah & Tamulaitis, 2000). Some member countries could however find the reintroduction of such actionable or non-actionable subsidies unfair or unfavorable. The main reason for this is that not all countries have the financial means to support their whole SMEs industry which would mean that they would have to limit their financial support to certain industries. Such actions however, would go against the Agreement on Subsidies and Countervailing Measures and would be open for international dispute (WTO, 2003).

As part of the committee on Subsidies and Countervailing Measures, you shall discuss on the existing Subsidies and Countervailing Measures agreement and on the possible (but not necessary) expansion or inclusion of SMEs subsidies as part of the actionable or non-actionable subsidies. Furthermore, you shall discuss how to avoid such rules being a setback to already existing agreement and if this would require an addition to the definition of a subsidy. At last, possibilities for special and differential treatment for LDCs and possibly developing countries, should be discussed within the scope of the SCM agreement. These negotiations shall not contradict any of the existing rules of other Agreements at the WTO and shall take into consideration the basic principles as is the most-favored nation treatment and the national treatment principles.
6. Committee on SMEs and dispute settlement:

Under other barriers that SMEs face within the international trade system, one that has already been mentioned by some scholars, is the dispute settlement system. Although the dispute settlement system is considered as one of the milestones that the WTO has been able to implement, it still presents some barriers for minor players in international trade, as is the case of SMEs (OECD, 2008, pp. 97-98).

Currently the Dispute Settlement Understanding (DSU) only allows for governments to bring cases to the dispute settlement court (WTO, 1994). Apart from this, legal costs for such a dispute settlement are high and almost inaccessible for most SMEs. (Nordström & Shaffer, 2008, p. 588; De Palo & Costabile, 2005)

Due to these restraints, it is in the best interest of WTO Members as well as the international trade system, to facilitate such procedures for Small and Medium Enterprises. As possibilities for this facilitations are:

- The implementation of alternative dispute settlement methods for smaller players like mediation or a Small Claims Court which could possibly solve minor disputes at much lower costs and faster. This could include systems of arbitration which are already existent under the DSU agreement (Nordström & Shaffer, 2008, pp. 604-606; WTO, 1994). Such alternative dispute settlement methods could further be made similar to those existing within the SPS Agreement (Art. 12.2) and NAMA Negotiations.
- Enable dispute settlement through internet technology. Although this might seem as a long-term solution, it is believed that the international trade system should take more advantage of such technologies (OECD, 2008, p. 98).
- Implement possible solutions which make it more attractive for governments to bring the disputes of these smaller cases to dispute settlement.

Solutions for the area of dispute settlement for smaller players seem to be a more distant goal. However, these issues have to be tackled already so that members as well as the WTO itself, can prepare themselves and create a framework, which facilitates the implementation of such measures.

In this committee you shall discuss the possible implementation of measures which facilitate SMEs access to dispute settlement on international basis. This should be done either an inclusion into the already existing Dispute Settlement understanding or as a new agreement or annex to an already existing one. Such rules shall not contradict any of the existing laws (unless you amend them) nor amendments of your colleagues in other committees.
References


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