Stocktaking Seminar on Small and Medium Enterprises and Low Income Developing Countries in the International Market Place

Co-organised by the G20 Turkish Presidency and the OECD
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Summary and Conclusions

SMEs are the backbone of economic activities in every country, and in particular in Low Income Developing Countries (LIDCs), and their further integration into the global economy will contribute to a more inclusive and robust growth, a key priority for the G20 Turkish Presidency. The OECD Secretary-General stressed in particular that unlocking the power of global trade and cross-border investment would offer a much needed stimulus to global growth. OECD preliminary analysis of the new TIVA data presented by the OECD G20 Sherpa (see below for additional details) indicates that GVCs continue to be a driving force of globalisation, with trade in intermediates growing at twice the rate of trade in final goods. The Turkish Presidency Sherpa further highlighted the importance of this issue in the context of the Presidency's priorities regarding Inclusiveness.

Better understanding of GVCs, the central contribution of the new OECD-WTO TiVA database

Several speakers, including the authors of the joint OECD – WBG draft report on *SMEs and LIDCs in GVCs - Options for Trade and Complementary Policies*, noted that gaps in data present a challenge to gain a clear understanding of the dynamics of GVCs, and in particular where matters concern SMEs and LIDCs participation. Further analysis of the patterns of specialisation in the context of a high level of fragmentation of GVCs would help identify where policy measures would have the highest impact. It is also important to identify the policy issues arising from the interplay between GVCs, innovation and the digital economy where new technologies are changing the nature of production.

The new OECD-WTO TiVA database presented by the OECD G20 Sherpa will make an important contribution in this regard. It provides data up to 2011 (2009 in the previous version of the database), including 4 more countries[1], 16 new sectors (including 7 additional manufacturing sectors and 9 additional services sectors), almost doubling the information available in the earlier version of the database. In addition, new indicators have been developed that provide new insights. One example is the export intensities of sectors and countries, while further new insights, through extensions to TiVA data, provide the basis for better comprehending the integration (or lack of) SMEs in GVCs (see next section).

New evidence on and avenues for the internationalisation of SMEs

The fragmentation of production has created new potential opportunities for relatively small firms – including in developing and emerging economies – to enter global markets as components or services suppliers, or to become micro-multinationals, without having to build a product's entire

[1] Namely Colombia and Costa Rica, as OECD accession countries; Croatia, as the 28th member of the EU; and Tunisia, marking the first step in expanding the database to the MENA region.

value chain. New niches for the supply of innovative products and services continuously emerge and pave the way for SMEs to exploit their relative flexibility. Speakers highlighted in particular that technological developments – such as e-platforms, digitalisation, and the internet, constitute levers for SMEs to digitally integrate themselves into the supply chain, and in particular in the services sector to exploit their entrepreneurial potential.

SMEs represent the vast majority of firms in all countries, but they typically contribute less than half of exports. However, these figures do not reveal the contribution of SMEs *as upstream suppliers* of large companies that are operating directly in GVCs. This statistical void is being addressed by the OECD building on the TiVA database. For example, preliminary data reveal that up to 70% of SME exports of value-added in Mexico are channelled through larger firms. Data also point to **a much greater degree of SME integration when the upstream effects are captured** (nearly 50% higher for example in the United States). Yet, the level of integration of SMEs in GVCs varies tremendously across countries and sectors, with for example, as little as 20% of the total value of manufacturing exports originating in SMEs.

In many countries, the higher the penetration of foreign investment in a sector, the lower the upstream contribution SMEs make to exports. This may reflect a number of factors, including the limited capacities of SMEs to integrate within domestic supply chains. Data therefore points to significant room for improvement via policies that can improve SME upgrading capabilities, and in turn, extract greater spillovers from FDI.

The policy challenge: The need for a comprehensive policy package for SMEs

While all participants agreed that open trade and investment policies should be at the centre of the policy choices, they further highlighted the need to take a holistic approach when promoting SMEs and LIDCs' participation in GVCs, as further analysed in the OECD-WBG draft report mentioned above. Indeed, as SMEs are relatively more impacted by the policy eco-system than larger companies (i.e policy reliant and policy dependant), they have less capacity to absorb policy deficiencies and shocks. Participants promoted a three-pronged approach whereby policy packages should: i) develop the internal capabilities of the firm, ii) promote a domestic environment conducive to integrating GVCs and iii) address the challenges due to external factors.

Speakers mentioned in particular policies supporting development of human capital and management skills as driver of firm productivity, tackling informal entrepreneurship, facilitating and incentivising innovation and technological adoption coupled with intellectual property frameworks. Financing of SMEs is a critical condition to build their capacity, grow to scale and enable them to integrate into GVCs. Finally, guaranteeing the quality and reliability of SME products for other producers and consumers is essential to GVC participation. In this regard, policies addressing certification and responsible business practices, as well as ensuring such information is effectively communicated to consumers, should be included in the package. Italy emphasised the importance of quality standards in a world characterized by globally fragmented production, noting the importance it attributes to geographical indications.

Policies promoting a **conducive domestic environment** should address bottlenecks in infrastructure and improvement of trade logistics to facilitate connectivity of SMEs with trading partners. Measures simplifying regulatory processes, reducing red tapes and improving transparency of clearance processes can help lower the costs. Most of these trade costs fall disproportionally on SMEs than MNEs.

Finally, trade policy measures that reduce red tape at the borders (trade facilitation) and facilitate access to both competitive (imported) inputs and foreign markets can have significant impact on GVC participation. A particular focus on efficiency of services was warranted by several participants, including Turkey which illustrated that services account for 22% of Turkey's exports but as much as 40% in value-added terms. Australia also stressed that liberalisation of four specific clusters of services, namely logistics/transport/distribution, communication, financial, and business services would help unlock growth. International regulatory cooperation also has a critical role to play in reducing business costs induced by the compliance with specific and often inconsistent domestic regulatory environments.

G20, a relevant platform to achieve progress

Participants highlighted the role that the G20 can play to address these issues. Indeed, the G20 encapsulates the key players whose firms are organising and shaping Global Trade and GVCs.

The main takeways from the *Stocktaking Seminar*, that could contribute to inform G20 trade discussions in the lead-up to the G20 Trade Ministerial meeting in October and to the G20 Leaders Summit thereafter, are:

- The importance of *identifying and implementing a comprehensive and multi-faceted policy agenda that would pave the way to firms of all sizes, in countries at all levels of economic development, to take full advantage of GVCs.* The G20 precisely offers a transversal and encompassing policy platform that is already dealing with some of the key areas that are instrumental in improving the situation for SMEs, in particular in LIDCs. This was highlighted by the Turkish Presidency.

- The abovementioned need for an holistic SME policy agenda makes the case for *the development of a G20 SME Action Plan* that would include options to enhance the performance of SMEs in GVCs, in particular policies to boost skills and improve capacity to invest and innovate and to use ICT tools in order to integrate digitally;

- *Services sector reforms*, notably in key network industries, can have a large impact on productivity and job growth and should therefore constitute a pivotal element of the G20 trade agenda going forward. Several speakers referred to the OECD services trade restrictiveness index as a useful tool to support and underpin a G20 ambitious initiative in this sector.

- The importance of *streamlining existing regulations* – some of which impose unnecessary costs on firms, placing the heaviest burden on SMEs, in particular those in LIDCs. The G20 could work to identify the most efficient international regulatory co-operation mechanisms for reducing trade costs.

- Red tape at the border disproportionally penalizes SMEs in countries at all levels of development. *Ratification of the WTO Trade Facilitation Agreement (TFA)* is therefore essential and should receive strong G20 political support. The latest analysis from the OECD, based on 2015 data across 152 countries, shows that implementing measures agreed to in the TFA could reduce trade costs by between 12% and 17.5%.

- *Improving access to finance for SMEs* is a critical enabler for their participation in GVCs. The work undertaken in the Finance Track to promote a diverse range of financing instruments for SMEs, and to develop high-level principles on SME financing, will be an important contribution in this regard.