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## SMEs in Services Trade – A GATS Perspective

Unlike traditional (goods-only) trade agreements, the scope of the General Agreement on Trade in Services extends beyond the treatment of products (services) to cover that of suppliers as well. The trade interests of particular groups of suppliers, including SMEs, can thus be addressed directly under the Agreement. This paper provides an overview of potentially relevant policies and policy disciplines. It also seeks to identify the scope for further initiatives, from fostering compliance with existing transparency obligations to advancing the Agreement's liberalisation and rule-making mandates from an SME perspective.

“Small opportunities are often the beginning of great enterprises.” Demosthenes (384-322 BC)

Studies and policy statements concerning small- and medium-sized enterprises (SMEs) tend to concentrate on manufacturing firms, if they distinguish at all between firms operating in different sectors. Relatively little attention is given to SMEs engaged in services production and trade, and even less is given to the status of SME-related policies under the General Agreement on Trade in Services (GATS). This may appear surprising for two reasons. First, services SMEs are a major contributor to overall production and employment in many economies. Second, unlike the General Agreement on Tariffs and Trade (GATT) rules governing trade in goods, GATS disciplines apply to both products (services) and suppliers. Thus, measures affecting different categories of suppliers, regardless of size or other criteria, fall within the scope of the Agreement.

What types of government intervention could affect SMEs? The European Commission has listed, by way of example, the following types of legal (policy-induced) barriers that service suppliers encounter when engaging in cross-border activities: nationality requirements, minimum capital requirements, quantitative restrictions and restrictions on multi-disciplinary activities.<sup>1</sup> However, while these barriers may disadvantage

exporting SMEs, some might actually benefit their domestic counterparts; nationality and residency requirements or restrictions on small-scale transactions, for example barring construction projects below a specified size, may well serve, unintentionally or otherwise, to protect market outlets for small, domestically established firms in the sectors concerned.<sup>2</sup> A broader picture would also cover support initiatives specifically targeted at SMEs, such as the free provision of market intelligence, trade promotion programmes and the like.

In contrast with some other studies, the following discussion pays no particular attention to genuinely size-related constraints such as productivity problems and business risks attributable to a small product and customer base. Nor will it address potential benefits, such as shorter decision-making channels, closer client relations and other flexibility-enhancing factors. Rather, our basic objective is to explore the scope for accommodating SME-related policy interests under the GATS and to trace such attempts as far as these are reflected in schedules of services commitments and relevant information sources.

We begin with empirical observations concerning the involvement of services SMEs in international trade, followed by an overview of GATS disciplines of various types from an SME-related policy perspective. This leads to a discussion of potentially relevant limitations as reflected in current commitments under the GATS and regional trade agreements (RTAs). A summary assessment of the current situation, in and around the WTO, concludes.

### SME involvement in international trade

As a general feature in all sectors, whether manufacturing or services, it appears that larger firms are more export-orient-

\* The authors would like to thank their colleagues for many inspiring comments. The usual caveats apply.

<sup>1</sup> European Commission: The State of the Internal Market for Services, Report from the Commission to the Council and the European Parliament presented under the first stage of the Internal Market Strategy for Services, COM(2002) 441 Final, Brussels, 2002, p. 14 ff.

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<sup>2</sup> By the same token, however, such barriers might have a disproportionate impact on other SMEs which rely heavily on imported inputs (including services) and might find it more difficult to switch to domestic alternatives than larger enterprises.

ed than their smaller peers. A report by the European Commission notes that the level of international activity is directly linked to firm size and negatively correlated with the size of the home country population.<sup>3</sup> The report distinguishes different forms of internationalisation: direct exports, foreign direct investment to set up a commercial presence abroad, technological co-operation with enterprises abroad, acting as a subcontractor for a foreign main contractor and having foreign subcontractors. Thus, not all findings fit into what might be considered exports within the modal structure of the GATS.

Several studies point out behavioural differences between services and manufacturing firms, as well as among the former.<sup>4</sup> As a general feature, services firms tend to engage less in international trade than their counterparts in manufacturing. However, there is a lot of variation both across sectors and types of firms. A study on UK service suppliers found, for example, that transport and communication were the most export-oriented sub-sectors, whereas distribution, hotels and catering lagged far behind (1988-2001). It also appears, according to another study, that large enterprises have more export destinations and trade in more types of services than small firms.<sup>5</sup>

3 European Commission: Internationalisation of European SMEs, Final Report, Brussels, 2010, pp. 5-6, 15.

4 The following observations are based on H. Hollenstein: Patterns and Determinants of International Activities: Are SMEs Different?, <http://e-collection.library.ethz.ch/eserv.php?pid=eth:24913&dsID=eth-24913-01.pdf> (last accessed 7 November 2012); H. Breinlich, C. Criscuolo: International Trade in Services: A Portrait of Importers and Exporters, in: *Journal of International Economics*, Vol. 84, 2011, pp. 188-206; A. Gourlay, J. Seaton, J. Suppakitjarak: The determinants of export behaviour in UK service firms, in: *The Service Industries Journal*, Vol. 25, No. 7, 2005, pp. 879-889; M.J. González Sanz, A. Rodríguez Caloca: Las características de las empresas españolas exportadoras de servicios no turísticos, Banco de España, *Boletín Económico*, 2010; United States International Trade Commission: Small and Medium-Sized Enterprises: Characteristics and Performance, USITC Publication 4189, Washington D.C., 2010; A. Minondo: Exporters of services in Spain, *Orchestra Working Paper Series in Territorial Competitiveness*, N. 2011-R04 (ENG), 2011; A. Henten, T. Vad: Service Internationalisation – Characteristics, Potentials and Barriers, CRIC Workshop on Internationalisation, Technology and Services: Analysis of Its Determinants and Implications for Competitiveness, Manchester, 2001; E. Masurel: Export Behaviour of Service Sector SMEs, Research Memorandum 2001 – 16, Amsterdam, 2001, Free University; A. Vogel: Exporter performance in the German business services sector, in: *The Service Industries Journal*, Vol. 31, No. 7-8, 2011, pp. 1015-1031; European Commission: Report on cross-border e-commerce in the EU, Commission Staff Working Document, Brussels, SEC(2009) 283 final, 2009; S. de Groot: Small businesses and online trading, UK Federation of Small Businesses, 2011; and OECD: Realising the potential of electronic commerce for SMEs in the global economy, Workshop 3, Conference on “Enhancing the competitiveness of SMEs in the global economy: strategies and policies”, Bologna, 2000.

5 It is not always clear, however, whether the definitions used correspond to the modal structure of the GATS. For example, are the nights spent by foreign tourists in holiday resorts counted as exports of hotel services under mode 2 (see following section)?

Services exporters reportedly differ from non-exporters in various regards. Research by the US International Trade Commission suggests that exporting SMEs are more productive in general and earn more revenue than firms serving only their home market. Similarly, studies on Spanish service firms, Dutch architectural firms and the German business service sector suggest that exporters are larger, pay higher wages and are more productive than non-exporters. Finally, firms with greater ability to accumulate knowledge were found to be more likely to export. Such observations are widely shared in principle, although the definitional demarcation of SMEs varies significantly among countries, reflecting differences in overall economic size and national specificities.

A closer look at European firms suggests that SMEs in wholesale trade tend to rely on direct exports, while those providing transport and communication services prefer subcontracting as their main form of internationalisation. SMEs offering business services were found to focus primarily on foreign direct investment and technical co-operation. Concerning relevant modes of supply, as defined under the GATS, little empirical evidence is available and, if so, the sectoral and geographical scope is limited. According to a study for Denmark, smaller service firms prefer delivering cross-border over establishing and supplying through a commercial presence abroad (mode 3 of the GATS). This finding seems to apply across all sub-sectors except financial services, where SMEs rely almost equally heavily on establishing abroad. Yet such studies need to be interpreted with caution, as they do not distinguish between EU-internal and -external trade, even though the economic conditions may differ markedly.

A more recent challenge has been the rapid evolution of e-commerce, offering new opportunities for cross-border supplies of many services. Empirical evidence, though relatively scarce, points out various firm-internal adjustment problems, which might be compounded by policy-induced impediments affecting on-line deliveries. According to the European Commission, EU stakeholders perceive the risk of fraud and non-payments, different fiscal regulations, and intellectual property rights issues as significant deterrents to IT-enabled trade. Also, language barriers, logistics and payment problems were mentioned as potential constraints. There have been various initiatives in the WTO intended to facilitate the longer-term evolution of e-trade, including the moratorium on customs duties on electronic supplies and the work programme on e-commerce.<sup>6</sup>

Small service suppliers are generally considered to be disproportionately affected by trade barriers such as discriminatory and non-transparent regulatory frameworks, com-

6 WTO document WT/GC/W/645.

mercial presence requirements, restrictions on the movement of personnel, and burdensome licensing and authorisation procedures. To our knowledge, however, there is no study that seeks to explore how WTO/GATS instruments could help to overcome such barriers. Potentially relevant initiatives might consist of liberalising commitments in relevant sectors and modes of supply, developing effective regulatory disciplines or, more immediately applicable, attaining stricter compliance with existing transparency provisions.

### Policies affecting SMEs - their status under the GATS

After some intensive discussions at early stages of the Doha Round, in 2001, SME-related issues seem to have lost traction in WTO fora. In September 2011, the Swiss delegation sought to reanimate the debate with a communication on the role of SMEs in the Swiss services economy, complemented in early 2012 by a submission discussing issues surrounding the electronic delivery of services from the perspective of SME exporters.<sup>7</sup> Despite repeated requests from the WTO Secretariat, however, apart from some references to existing studies, no Member provided evidence of barriers actually encountered by service-trading SMEs or established links with potential remedies under the GATS.

#### General framework

The disciplines governing merchandise trade under the GATT essentially focus on the treatment of products traded cross-border. In contrast, reflecting the GATS extension to three additional modes of supply – consumption abroad (mode 2), commercial presence (mode 3) and presence of natural persons (mode 4) – key disciplines extend as well to the treatment of service suppliers and their staff, either indirectly through measures operating on the consumer or directly in the form of investment grants, equity ceilings, work permits and the like. For each subsector subjected to specific commitments, a Member must specify the levels of market access and national treatment accorded under the four modes. While market access commitments relate to the absence of six types of restrictions listed in GATS Article XVI:2, national treatment commitments, governed by Article XVII, essentially guarantee the absence of any measure that would modify the competitive conditions in favour of domestic services and suppliers vis-à-vis their foreign equivalents.

In addition, pursuant to Article XVIII, Members may assume additional commitments concerning “positive” undertakings relating, for example, to the adoption of international standards or specified competition disciplines. Although the Article would allow Members to schedule such under-

<sup>7</sup> WTO documents S/C/W/340 and 345.

takings in pursuit of SME-related policies, it has played no particular role to date in any sector other than telecommunications.<sup>8</sup>

To protect the right to depart from unfettered market access and national treatment, governments must inscribe the measures they might want to use as limitations in their schedules of commitments. Article XVI:2 provides that four of the six types of restrictions concerned – quotas on the number of suppliers, value of transactions, number of operations (e.g. establishments), quantity of output and number of natural persons involved – might also be maintained in the form of an economic needs test (ENT). In non-scheduled sectors, market access or national treatment may be completely denied. However, most-favoured-nation (MFN) treatment must be extended regardless of the existence of commitments, though departures are permissible in specified circumstances, including among participants in regional trade agreements. Similarly, even in committed sectors, individual modes can be completely exempt from any market access or national treatment obligations. Like tariff bindings under the GATT, such scheduled limitations protect a Member’s right to maintain or introduce the specified measure(s) but do not necessarily reflect the prevailing trade regime, which might be more open at any point in time.

The flexibility of the GATS allows Members to exempt sector segments from commitments that are typically served by SMEs. However, such cases are significantly less frequent than limitations that, without directly targeting suppliers of different sizes, have size-specific effects. For example, restrictions on cross-border supply could disadvantage smaller firms against larger companies, which may find it easier to mobilise the resources necessary to establish and operate a permanent presence abroad. Similar effects may arise from limitations requiring the parent company to have been established for a minimum number of years, thus effectively precluding younger firms, which are likely to be smaller, from moving into the market concerned. However, a variety of policy measures that may have size-specific effects are not subject to scheduling at all, including minimum capital and other minimum size requirements. The status of certain measures such as local incorporation requirements may need to be assessed case-by-case in the light of potentially relevant provisions. For example, it could be argued that such requirements modify the conditions of competition between national and foreign suppliers in the

<sup>8</sup> The vast majority of the 100-odd Members that assumed additional commitments confined these to the competition safeguards, interconnection guarantees and other principles contained in a so-called reference paper on telecommunications. SME-related interests are covered insofar as they coincide with the underlying pro-competitive policy paradigm.

sense of Article XVII whenever (i) the services concerned could easily be provided cross-border and (ii) relevant rules are more difficult/costly for foreigners to comply with than for domestic firms.

### SME-related policies as reflected in schedules of commitments

The vast majority of current schedules were submitted towards the end of the Uruguay Round in 1993/1994. They reflect the prevailing policy considerations at the time and should have been re-negotiated since. GATS Article XIX:1 explicitly commits Members to enter into successive rounds of services negotiations “with a view to achieving a progressively higher level of liberalization”. The first such round commenced in January 2000, as mandated in the Agreement, to be subsequently integrated into the wider Doha Round context (which was launched in December 2001). While 71 Members tabled services negotiating offers between March 2003 and August 2007 which were later improved in 31 cases, there have been no new submissions since early 2008, reflecting the stalemate in the Round.<sup>9</sup> In general, the content of these offers does not depart extensively from current schedules; many participants might be trying to hold onto negotiating coinage for the final stages of the Round.

#### *Sector column*

The vast majority of Members, including the EU, have scheduled commitments in accordance with the Sectoral Classification List (MTN.GNS/W/120) developed by the GATT Secretariat in 1991. The list distinguishes some 160 sub-sectors, allocated to 12 “mega-sectors”. Since compliance is not mandatory, Members could exclude sector segments from commitments that are typically served by SMEs, thus retaining the right to operate whatever measures they feel necessary, including outright entry prohibitions. For example, some developing countries have confined their commitments on hotel services to the luxury category (three- or four-stars and above), thus protecting more modest facilities from foreign competition.

#### *Market access*

Most size-related limitations can be found in the market access column, either in the horizontal section, which applies across all scheduled sectors, or in individual areas.<sup>10</sup> Rel-

<sup>9</sup> The 25 EU member states at the time were covered by one offer.

<sup>10</sup> In certain cases, entries might have been misplaced: measures that seem to fall under market access show up in the national treatment column and vice versa. As far as possible, we have treated the measures concerned as if they had been inscribed in conformity with GATS provisions.

evant limitations exist almost exclusively in the schedules submitted by developing countries. For example, under mode 3, several Caribbean countries maintained the right, on a horizontal basis, to reserve “a number of small business opportunities for nationals”. Accordingly, the governments remain free to adopt any of the restrictions falling under Article XVI to protect domestically owned SMEs.<sup>11</sup> On the other hand, considering the vagueness of the terms used, the question arises as to what extent such commitments actually serve their basic purpose of guaranteeing, in a transparent and predictable manner, specified degrees of market access.

Several Members explicitly spelled out size-related criteria in the context of the ENTs they scheduled under market access for mode 3. Cases in point are references to floor space or number of rooms, geographical spread, distance between existing facilities and the like. However, over one-third of existing ENTs do not contain any criteria, while many more provide only vague indications. Like a variety of other “foggy” entries in schedules, these may also be used to pursue size-related policy intentions.<sup>12</sup> Non-specified ENTs have also been scheduled by OECD countries, including EU member states such as Italy, Malta and Sweden.

Concerning mode 4, the level of commitments, mostly inscribed in the horizontal section, is quite shallow in virtually all schedules. Few entries allow for independent access outside established company networks, which would be particularly relevant for employees of small foreign-based suppliers and independent professionals.<sup>13</sup> A somewhat higher incidence of such commitments can be found in the schedules of newly acceded WTO Members.

Relatively frequent non-bindings on cross-border trade may also disadvantage SMEs, which tend to prefer such transactions to commercial establishment abroad. While the emergence of IT-enabled services has overall created new market opportunities, not least for small firms, existing commitments mostly reflect the technical and institutional conditions some 20 years ago. However, without progress in the Doha Round, the prospects for change appear quite slim.

<sup>11</sup> There are also limitations, though rare, that provide niches for foreign-based SMEs. Concerning architectural services, South Africa stipulates that the services of a local architect are required for building plans of 500 m<sup>2</sup> and above. Accordingly, foreign architects involved in smaller projects, not normally served by large firms, could directly interact with their clients. In a similar vein, Bulgaria’s schedule stipulates that architectural and engineering services can be supplied “only in partnership with, or as subcontractors of, local service suppliers [if] the project is of national or regional significance”.

<sup>12</sup> See R. Adlung, P. Morrison, M. Roy, W. Zhang: FOG in GATS Commitments – Why WTO Members Should Care, in: World Trade Review, FirstView, December 2012, pp. 1-27.

<sup>13</sup> WTO document S/C/W/301.



### National treatment

The most frequent national treatment limitations that are explicitly size-specific relate to subsidies under mode 3, sometimes in combination with one or more other modes. For example, Mexico has reserved the right to extend research and development subsidies only to domestically owned “small service enterprises”. As in many other cases, an element of uncertainty remains, as no further definition of such enterprises is provided.

As indicated above, various Members have scheduled residency, local partnership and local presence requirements as limitations, mostly under modes 1, 2 and 4. For example, Poland, Slovenia and Sweden have done so for travel agencies, tour operators and the like. While it might still be possible to access these markets on a cross-border basis, using local offices as a conduit, the cost of doing so is certainly higher than in the case of unfettered access.<sup>14</sup> And SMEs are relatively more affected than their larger peers.

Certain training requirements, typically scheduled under modes 3 and 4, may have similar effects of increasing the fixed cost of market entry and participation and thus tilting the playing field against small foreign providers. Such requirements are contained in the horizontal section of 12 schedules, primarily developing countries and LDCs. Further examples can be found in a sectoral context, including in tourism services (Egypt and Niger).

### Situation in non-scheduled services

In non-scheduled sectors, as indicated before, governments remain free to employ any restrictions, on an MFN basis, for any policy purposes. While the schedules of a few LDCs contain only one subsector, i.e. less than one per cent of the “services universe” as defined by the Sectoral Classification List, some recently acceded transition economies inscribed 130 and more. On average across all Members, no more than one third of all subsectors are currently covered.<sup>15</sup>

Members’ scheduling decisions may be viewed from a sectoral perspective. Overall, tourism is clearly in the lead, represented in 95 per cent of all schedules.<sup>16</sup> Financial services, a broad range of professional and other business services,

14 Of course, this is true only for services that could normally be supplied without local assistance and not for others that are typically provided via commercial presence (hospitals, hotels, restaurants, etc.). Local presence requirements in the latter sectors have thus been ignored in the context of Table 1.

15 R. Adlung, M. Roy: Turning Hills into Mountains? Current Commitments under the General Agreement on Trade in Services and Prospects for Change, in: Journal of World Trade, Vol. 39, No. 6, 2005, p. 1168.

16 Ibid, p. 1170.

and telecommunications follow, trailing by some 15 to 25 percentage points. In contrast, education and health have been scheduled by less than 40 per cent of Members.<sup>17</sup> Interestingly, many of the most frequently scheduled services, including financial and telecommunication services, are dominated by larger firms, while sectors such as health, education or distribution, which feature less prominently, are made up of smaller entities as well.<sup>18</sup> This could imply that size-related considerations form part of the sensitivities and constraints governing governments’ sector selection for scheduling.

### Policy discretion in liberalised sectors/modes

Members may well maintain a wide range of size-related policy schemes despite the existence of full commitments in the services concerned. Potentially relevant measures are discussed below.

### Market regulation and control

Among the many policies that define the framework conditions of market entry and participation, the following tend to favour small-scale entities vis-à-vis larger competitors:

- strict zoning laws, including restrictions on maximum service areas and opening hours;
- obligations on providers of infrastructural services, in particular financial services, to prioritise SMEs, for example via preferential lending;
- competition disciplines that seek to ensure continued market contestability and prevent abuse of dominant positions (merger controls, prohibition of collusive practice, etc.);
- prohibitions/restrictions on performing multi-product activities (for example, prohibition of partnerships between lawyers and non-lawyers such as accountants and tax consultants).<sup>19</sup>

In contrast, SMEs tend to be adversely affected by:

17 Not even all EU members have undertaken commitments in these services. The education sector has not been scheduled by Cyprus, Finland, Malta, Romania and Sweden, while hospital services have been omitted by Bulgaria, Cyprus, Czech Republic, Finland, Malta, Romania, Slovak Republic and Sweden.

18 At first glance, the most frequently scheduled sector, tourism, seems to defy this pattern, given its relatively high share of small enterprises. However, hotels and restaurants, a subsector of tourism, account for a very significant number of SME-related limitations (see Table 1).

19 Small businesses might benefit from such measures if the resulting market segmentation deprives larger (potential) competitors of size-related economies.

- high licensing fees, administrative red tape and similar regulatory requirements that tend to increase the fixed cost of market entry/participation;
- minimum capital and comparable minimum size requirements which, while possibly serving public policy purposes (reliability and stability of supplies), effectively exclude small or occasional suppliers from the markets concerned;
- universal service obligations on suppliers of telecom, transport, health and other public services with similar intentions and effects.

As noted before, such measures would not need to be scheduled as long as they cannot be associated with restrictions falling under Article XVI or with competitive distortions within the meaning of Article XVII. However, the borderline with restrictions that require scheduling could be blurred in some instances.

An additional aspect might need to be kept in mind: the ongoing negotiation on domestic regulatory disciplines under Article VI:4 of the GATS. The mandate provides for the development of any necessary disciplines to ensure that licensing and qualification requirements and procedures and technical standards “do not constitute unnecessary barriers to trade in services”. Such disciplines shall aim to avoid, *inter alia*, that relevant requirements are “more burdensome than necessary to ensure the quality of the service”. This mandate is certainly broad enough to address some of the barriers mentioned above (excessive licensing fees, capital requirements, etc.) if deemed necessary. However, given the wider context of the Doha Round (non-)negotiations, no outcome is currently in sight.

#### *Investment- and production-related support schemes*

According to information contained in WTO Trade Policy Review (TPR) reports over the period 1995-2007, a number of Members provided subsidies and similar incentives that, directly or indirectly, had size-related effects.<sup>20</sup> While it is fair to assume that such schemes generally favour national investors, it was explicitly clarified in some cases that the measures were extended on a non-discriminatory basis. In general, priority would be given to small enterprises, not least in the hotel sector. Relevant measures include subsidised loans, tax incentives related to investment or training and import duty exemptions for materials used.

<sup>20</sup> This information is based on overviews contained in WTO documents S/WPGR/W/25, including addenda 1 to 5; WT/TPR/S/33, para 184; WT/TPR/S/127, para 17.

#### *Export assistance*

Unlike the GATT, the GATS does not restrict Members' ability to promote exports. There is no services equivalent to the prohibition of export subsidies pursuant to Article 3(a) of the Agreement on Subsidies and Countervailing Measures. Nor would such subsidies be inconsistent *per se* with any of the provisions governing market access or national treatment. There is thus no possibility to infer from scheduled limitations the existence of export-related policy schemes, such as direct financial support, export guarantees or specific professional training programmes.<sup>21</sup>

Again, relevant information on SME-related assistance, though not systemically collected, may be contained in TPR reports. A case in point is Australia's Export Market Development Grants scheme, which has an SME focus (up to 50 per cent of export promotion expenses incurred by Australian residents may be reimbursed).<sup>22</sup> The question remains, of course, whether such support schemes are actually known to, and easy to apply for, potentially qualifying exporters.

#### *Preferences in government procurement*

In a recent communication on its strategy for supporting SMEs in international markets, the EU pledged “to make the interests of small businesses in access to international procurement markets a priority in the WTO negotiations”.<sup>23</sup> However, to what extent are other WTO Members prepared to respond? The only substantive obligations that exist in a multilateral context have been exchanged among the 15 parties of the recently renegotiated plurilateral Agreement on Government Procurement (GPA), which covers goods and services. According to its Article II, the GPA applies only to purchases above or equal to the threshold values specified in the Parties' annexes to Appendix I (usually around SDR 130,000 for central government entities), and this appears to be well beyond the reach of many SMEs.

The GATS itself does not impose any effective disciplines on a government's use of procurement for any policy purposes. Article XIII provides that the MFN, market access and national treatment obligations do not apply to the purchase of services by governmental agencies for governmental purposes. Thus, Members' commitments do not capture any discriminatory elements contained in, or arising from,

<sup>21</sup> This applies as long as the eligibility criteria do not discriminate between foreign and domestically owned exporters.

<sup>22</sup> Austrade: [www.austrade.gov.au/Waht-Is-EMDG/default.aspx](http://www.austrade.gov.au/Waht-Is-EMDG/default.aspx) and WTO document, WT/TPR/178/Rev.1.

<sup>23</sup> European Union: Small Business, Big World: a new partnership to help SMEs seize global opportunities, Europa, Press Release RAPID, 2011, <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/765&format=TML&aged=0&language=EN&guiLanguage=en>, (last accessed 7 November 2012).

national procurement laws. While Article XIII also calls for multilateral negotiations on government procurement to be conducted, no tangible progress has been achieved to date. The EU is one of the very few Members that have sought, through various submissions, to advance these negotiations.<sup>24</sup>

Relevant information on SME-related procurement practices may be derived from a variety of sources, including information submitted under the GPA. For instance, the United States provides set-asides for small and minority businesses, which ranged from 12.5 per cent of covered federal procurement in 1992 to 22 per cent in 2007 and are granted only to domestically incorporated firms.<sup>25</sup> Canada and South Korea also listed exemptions for small businesses from GPA coverage.

Interestingly, according to a 2005 survey of 28 European countries, only Greece had a regulation expressly favouring SMEs in public procurement.<sup>26</sup> Companies were registered in classes depending on their size and the type of contracts sought; lower-class registered companies could compete for smaller contracts while higher-class registered companies could not. However, regulations in a few other European countries (e.g. France, Germany, Norway and Sweden) may have benefited SMEs indirectly. Relevant provisions ranged from decentralisation of procurement and simple notification procedures for contracts with low thresholds (Norway) to an obligation to accept groups or associations of bidders and treat them as a single bidder (Germany) in order to facilitate the participation of SMEs in public tenders. According to an EU survey on SMEs' access to public procurement, "breaking down tenders into lots is commonly seen as one of the most important tools that help SMEs accessing public tenders".<sup>27</sup> Cyprus, Slovenia, France and Poland reportedly are the most frequent users of this approach.

### Transparency disciplines

Pursuant to Article III:3 of the GATS, the Council for Trade in Services needs to be notified of any changes to laws, regulations or guidelines that "significantly affect" trade in com-

mitted sectors. This is regardless of whether such changes fall under the provisions of Articles XVI or XVII of the GATS or whether they consist of domestic regulatory adjustments that are not subject to scheduling. It might thus be expected that the notifications received over the years, at least in committed sectors, would indicate directions of policy change, including in areas relevant to SMEs. However, Article III:3 has been ignored by most Members, including the EU.<sup>28</sup>

Of approximately 350 notifications submitted over the past decade, more than half originated from just three Members: Albania, China and Switzerland. With possibly the sole exception of Brazil, there is no indication that SME-related policy objectives or concerns played a dominant role in any of these notifications.<sup>29</sup>

The GATS also contains transparency provisions that might prove relevant to developing country SMEs seeking to explore access opportunities abroad. Pursuant to Article IV:2, developed country Members and, to the extent possible, other Members are required to operate contact points through which developing country suppliers can obtain potentially relevant commercial and technical information. According to the notifications received, such entities have been established by over 100 Members. There are doubts, however, as to whether they really perform their tasks.<sup>30</sup>

### Overview of size-related commitments – GATS and RTAs

The following observations are based on the GATS schedules in force in late March 2012, covering 153 WTO Members. Apart from the full range of horizontal entries, the limitations inscribed for a pre-selected sample of sectors were taken into account. The sample focuses on services considered to be particularly relevant for SMEs: professional services, other business services, distribution, construction and related engineering, hospital services, other human health and social services, hotel and restaurants, other tourism and travel-related services, insurance, and banking.

24 See also WTO documents S/WPGR/W/39, S/WPGR/W/42, S/WPGR/W/48, S/WPGR/W/52 and S/WPGR/W/54.

25 See also Federal Acquisition Regulation, 19.102(a), 19.501(a) and 19.502-2; Code of Federal Regulations, 13 CFR 121.105; WTO documents WT/TPR/S/16; WT/TPR/S/16; and WT/TPR/S/235/Rev.1.

26 The survey covered the EU25 (excluding the Netherlands) as well as Croatia, Iceland, Liechtenstein and Norway. It was carried out by Public Procurement Network, an informal European-wide co-operation initiative. See [www.publicprocurementnetwork.org](http://www.publicprocurementnetwork.org).

27 GHK: Evaluation of SMEs' Access to Public Procurement Markets in the EU, DG Enterprise and Industry, Final Report, 2010, pp. 36 and 42, [http://ec.europa.eu/enterprise/policies/sme/business-environment/files/smes\\_access\\_to\\_public\\_procurement\\_final\\_report\\_2010\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/business-environment/files/smes_access_to_public_procurement_final_report_2010_en.pdf) (last accessed 7 November 2012).

28 In the context of a recent Trade Policy Review, the European Commission argued, by way of explanation, that the scope of potentially relevant measures was extremely broad, no reliable statistics were available and a lack of clear standards made it impossible to determine which trade effects were "significant". WTO document WT/TPR/S/248/Rev1.

29 Brazil notified of two measures governing small entrepreneur finance companies; WTO document S/C/N/145.

30 In the context of a recent study, Marchetti and Mavroidis repeatedly approached the contact points of 18 WTO Members. However, they received no replies. J. Marchetti, P. Mavroidis: I now recognize you (and only you) as equal: an anatomy of (mutual) recognition agreements in the GATS, in: I. Lianos, O. Odudu (eds.): *Regulating Trade in Services in the EU and the WTO*, Cambridge, 2012, pp. 415-444.

In counting limitations, we distinguished between measures that are directly size-related and others that may have size-related (side-)effects. The former category comprises: (a) reservations for and/or exclusions of SMEs from commitments; (b) prescribed minimum amounts of foreign investment and/or capital; (c) size-related ENTs; and (d) subsidy-related preferences in favour of domestic SMEs. In turn, size-related (side-)effects might be associated with restrictions on cross-border trade or on the entry of independent professionals, residency requirements, training requirements, poorly specified ENTs and the like.

It is important to note that the positive effects on domestic SMEs expected to arise from these measures may come at the expense of small foreign suppliers that also seek to serve the markets concerned under relevant modes.

### GATS commitments

#### *Horizontal limitations*

In total, 28 Members have inscribed explicitly size-related limitations in the horizontal section of their schedules: 17 under market access (MA), 8 under national treatment (NT) and the remaining 3 in both columns (see Table 1). The focus is on mode 3 (19 limitations), followed by mode 4 (6). The most frequently scheduled measures are reservations of business opportunities for small companies and/or SME-specific employment criteria, with 18 cases in the horizontal section.<sup>31</sup>

In addition, there are very many entries that may have size-related (side-)effects. In particular, nearly 90 Members inscribed mode 4 limitations which provide no scope for access unrelated to commercial presence. Independent service suppliers or employees of foreign-based firms seeking to perform a contract could thus be denied entry. Local incorporation and/or joint venture requirements rank second in this regard; they show up in some 20 schedules.

#### *Sector patterns*

From a sectoral perspective, explicitly size-related limitations are particularly frequent in banking (20 schedules), hotels and restaurants (14), insurance (8), and distribution (6).<sup>32</sup> The most prominent entries are, predictably, size-

specific reservations or exclusions in commitments, followed by discriminatory minimum capital or investment requirements and size-related ENTs.

Banking accounts for the highest number of reservations or exclusions that might prove relevant for SMEs (13) as well as discriminatory minimum capital and investment requirements (8). Many such limitations may reflect predominantly prudential concerns, especially in financial services. However, this is certainly not the case for sectors such as hotel and restaurant services, where several size-related limitations may be intended to provide niches for domestically-owned SMEs. They mostly specify the number of hotel rooms or the hotel ratings (stars).

The terms used to express limitations, as well as their clarity and precision, differ among sectors and schedules. For example, entries concerning construction and related engineering services and architectural services refer to minimum contract values or, more vaguely, to the geographical significance of projects as a prerequisite for access. In banking, size-related entries are expressed, *inter alia*, in terms of total assets, deposits or lending value, or capital.

Concerning the wide range of limitations that may potentially benefit domestically-owned SMEs, it is problematic to rank relevant entries, since the actual trade effects may vary widely among sectors.<sup>33</sup> Nevertheless, according to a rough count, non-bindings on cross-border supplies constitute the most frequent category, contained in over 120 schedules. Residency and commercial presence requirements rank next; they have been scheduled by about 40 WTO Members, including EU member states, primarily under other business services, insurance and professional services.

### Regional trade agreements

Issues related to SMEs have also been addressed in regional trade agreements (RTAs). Out of a sample of 66 RTAs, 46 contain SME-related elements of different scope and depth, 20 of which refer specifically to trade in services.<sup>34</sup> About half of these deal with SME-related issues in the main text, often in general terms (e.g. facilitating SMEs' use of e-commerce, promoting a favourable environment for the development of SMEs), in addition to the respec-

31 For example, Bulgaria's schedule provides under market access, mode 4, that the number of intra-corporate transferees within an internationally active company must not exceed ten per cent of the number of nationals employed, except for companies with fewer than 100 employees, where higher shares may be authorised.

32 The numbers do not always correspond to those given in Table 1, since a single schedule might contain several types of limitations in the same sector.

33 For example, a residency requirement is possibly more burdensome for architects than for medical doctors, who generally provide their services on a permanent basis in one location.

34 The sample has been taken from among 84 RTAs notified to the WTO under the relevant GATS provision, Article V:7, by late August 2011 (excluding the EC Treaty and subsequent EC enlargements) and covers all agreements in which China, India or an OECD country participate.



**Table 1**  
**Entries in GATS schedules potentially benefitting domestically-owned SMEs**

Measure	Most relevant column/mode	Total	Number of Members/schedules	
			Horizontal section	Sector section <sup>a</sup> (Three most frequent cases)
<b>(i) Explicitly size-related limitations</b>				
Reservations/exclusions of SMEs from commitments	MA / 3	42	18	Banking (13) Hotels and restaurants (11) Insurance; distribution; prof. serv. (4)
NT-inconsistent minimum capital or investment requirements	NT / 3	17	7	Banking (8) Insurance (4) Hotels & rest.; other business serv. (1)
Economic needs test with size-related criteria	MA / 3	9	1	Distribution (3) Hotels & restaurants (2) -
NT-inconsistent taxes or subsidies	NT / 3	3	3	0
<b>(ii) Potentially relevant limitations</b>				
No bindings on cross-border trade	MA, NT / 1, 2	122	0	Other business services (72) Hotels & restaurants (68) Professional services (62)
No mode-4 commitments unrelated to establishment	MA, NT / 4	87	87	0
Residency and commercial presence requirements <sup>b</sup>	MA, NT / 1, 4	42	3	Other business services (18) Insurance (18) Professional services (14)
Economic Needs Test without precise criteria	MA / 3	39	7	Insurance (13) Hospitals (12) Banking (10)
Local incorporation and joint venture requirement	MA / 3	35	18	Insurance (14) Banking (13) Distribution; other business services (2)
NT-inconsistent training requirements	NT / 3	15	12	Hotels & restaurants (2) Distribution (1) -
No bindings for taxes, subsidies, etc.	NT / 1, 2, 3	13	13	0

Note: <sup>a</sup> Numbers of the most frequently affected sectors in parenthesis; <sup>b</sup> Includes local-partnership requirements.

Source: WTO.

tive schedules of commitments. Also relatively frequent (in ten RTAs) are references, again mostly in general terms, to SMEs' participation in government procurement. While a few RTAs provide for joint initiatives in favour of SMEs, the content generally remains vague. It appears, in some cases at least, that such entries are intended mainly to address popular policy concerns.

Concerning the services schedules contained in our RTA dataset, explicitly size-related limitations are almost

equally distributed between market-access and national-treatment commitments. In 17 schedules, horizontal limitations have been used, mostly consisting of exclusions of SMEs from commitments (14 schedules). Not surprisingly, there are frequent similarities with GATS-scheduled limitations. Regarding individual services, hotels and restaurants again account for the lion's share of the sector-related limitations – they are contained in 11 schedules of our RTA sample, followed by financial services (4) and distribution (2).

### Size effects of scheduling patterns – GATS vs. RTAs

More and more publications deal, in a comparative way, with the obligations assumed by WTO Members under the GATS and under regional trade agreements. One study stands out insofar as it focuses on SME-related implications to be expected from differences in scheduling patterns between the two sets of commitments.<sup>35</sup> Starting from the assumption that SMEs typically prefer exporting through “soft” modes of supply delinked from commercial presence (e.g. cross-border supply and movements of contractual service suppliers), while large companies rely more strongly on foreign direct investment (mode 3) and, subsequently, movements of intra-corporate transferees, the study shows that the gap between the two approaches is significantly smaller in RTAs than in Doha Round offers (as noted above, the latter are largely comparable to existing GATS commitments). RTAs thus tend to level the playing field between SMEs and larger enterprises insofar as they improve market access in modes presumably preferred by SMEs, too.

The comparison between RTAs and GATS commitments/offers could have been influenced by a time factor, however. Most current RTAs were concluded after 2003/2004, when the majority of Doha Round offers had been submitted. It is thus not inconceivable that the results are attributable, inter alia, to policy perceptions at the time and that future scheduling patterns under GATS could come to resemble their RTA counterparts.

### Summary

Given its broad policy coverage, including the extension from product trade to the treatment of suppliers, the GATS offers more scope for addressing SME-related issues than possibly any other multilateral agreement within the remit of the WTO. Pursuant to Article I:1, the Agreement applies to government measures affecting trade in services, and this includes measures that differentiate among suppliers of different size. Accordingly, WTO Members could not only accommodate but actively pursue SME-related objectives under the GATS. In addition, the Agreement contains particular transparency disciplines, including the requirement to establish contact points for developing country suppliers which may especially benefit small companies and independent professionals.

Nevertheless, SME-related concerns have not been addressed systemically in WTO fora to date. Relevant exchanges more recently have focused mainly on the contribution of SMEs to production, employment and trade. A discussion of

trade barriers perceived to impede such suppliers, and remedial measures that Members might take, would still have to be launched.

A common denominator that could, or should, inform such a discussion is the economic importance of a smoothly functioning regulatory and institutional framework for trade. The smaller a company, the greater the benefits it derives from low-cost market entry and participation. While technical progress has dramatically increased the potential for cross-border trade through electronic means, other (policy-induced) impediments have remained. They might now deserve even more attention than one or two decades ago. Although the EU might be well placed to stimulate relevant discussions in Geneva given its own internal experience with, and analyses of, SME-related policy issues, it has not yet played a leading role.

Potentially relevant barriers range from size-related restrictions falling under the market access or national treatment provisions of GATS (e.g. local presence requirements) to regulatory measures not subject to scheduling (e.g. minimum equity standards and high licensing fees). Obviously, this would argue for a two-pronged strategy: trade liberalising negotiations as mandated in GATS Article XIX and the development of regulatory disciplines pursuant to Article VI:4. In addition, compliance with existing transparency obligations under the Agreement might deserve further attention. While most Members, including the EU, have largely ignored such obligations to date, the European Commission at least expressed support for (nascent) initiatives to improve the notification mechanism and clarify its scope.

Ideally, a focused discussion of SME-related interests would extend to the external effects of domestic support policies. To what extent are these undermined by similar efforts abroad? Is there scope for parallel reductions of discriminatory (i.e. national treatment inconsistent) procurement restrictions, subsidy schemes and the like? And are there alternatives to regulatory interventions for prudential and similar reasons (high minimum equity standards, residency requirements, etc.) that would have a less deterrent impact on SMEs?

The prospects of such initiatives in the WTO may appear gloomy at present, given the uncertain fate of the Doha Round. Nevertheless, the recent proliferation of RTAs clearly indicates that the making of trade policy has not come to a halt – quite the contrary. Yet bilateral or regional agreements do not offer the forum necessary for a systemic exploration of the issues raised above, be they definitional, transparency-related, regulatory, etc. If the underlying concerns are widely shared, there is no substitute to having them addressed in the WTO. If there is a will, one might expect that there is a way.

35 D. Persin: Market Access for Small versus Large Service Enterprises: The Preferential and Multilateral Trade Liberalization Tracks Compared, in: *Journal of World Trade*, Vol. 45, No. 4, 2011, pp. 785-819.