

House Committee on Small Business

Hearing

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***Impact of Recent and Pending Free Trade Agreements
on Small Businesses***

Statement by

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Chairman Graves and members of the Committee, thank you for inviting me to testify. My name is Gary Hufbauer and I am a Senior Fellow at the Peterson Institute for International Economics, a non-profit, non-partisan policy research institute.¹

In thinking about the impact of free trade agreements (FTAs) on US small business firms, it is useful to distinguish between *direct exports* and *indirect exports* of these firms. Trade agreements improve both channels.

Direct Exports by Small Business

Over 300,000 American small business firms, defined as firms with fewer than 500 employees, directly export goods and services to foreign markets. These firms number 98% of all US firms that export; between 2002 and 2010 they contributed about a third of total US merchandise exports, and this share seems to be rising.² Since small business firms account for almost half of US employment,³ their direct export share is somewhat less than their employment share.⁴ However, small businesses that export usually grow faster, increase employees, and pay higher salaries than those that just sell domestically. Canada is the top destination country for small business exporters, followed by China, the United Kingdom, Mexico, and Australia. It is not a coincidence that the United States has free trade agreements with three of these countries, and that the English language is spoken in three of them – features that make doing business abroad much easier.

Indirect Exports by Small Business

Small business firms play an important role as suppliers to multinational corporations that in turn export everything from heavy equipment and aircraft to entertainment and software. A large

¹ Sean Miner, Research Analyst at the Peterson Institute, gave valuable assistance in preparing this testimony.

² SBA, Office of Advocacy, FAQ http://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf

³ <http://www.ustr.gov/about-us/press-office/blog/2013/june/ustr-celebrates-small-business-week>

⁴ See National Small Business Association and the Small Business Exporters Association Survey <http://news.yahoo.com/small-business-exports-picking-survey-040313009.html>. For more than half of small business exporters, exports account for less than 10% of revenue. Exports account for more than half of revenue for only one in seven small business firms.

volume of exported goods and services are intermediate products that are combined with other intermediates in global value chains (GVCs). Again, small business firms supply a large share of goods and services to these GVCs. Unfortunately, official statistics do a poor job of tracking indirect exports of small business firms. To give an indication of how important such sales might be, a recent evaluation by the OECD and WTO concluded that, after properly accounting for specialized business services purchased by manufacturing exporters, services contribute fully 40% of the value of world exports, about twice the direct export figure reported in official statistics.⁵ My guess is that a similar calculation of indirect exports by small business firms would boost their contribution perhaps to 50% of US exports. The US Department of Commerce and the US International Trade Commission should do a much better job of tracking the indirect exports of small business firms.

Impact of Free Trade Agreements

FTAs make a significant positive impact on small business exports by lowering the fixed and variable costs of doing business abroad. They do this by eliminating tariffs, cutting red tape at the border, simplifying international payments, and allowing multiple entries on a single business visa.

A recent survey by the International Trade Commission on the effects of the Korea-US FTA on small and medium size enterprises (SMEs) found that respondents viewed the FTA in a favorable light, and expected benefits to grow over time.⁶ The report stated that small manufacturers experienced an improved trading environment in Korea by opening new business opportunities, strengthening business relationships, and fostering more regular sales. US agriculture firms also increased their exports, especially where high tariffs were cut or eliminated. Service sales improved, often attributed to the better environment for intellectual property rights (IPR).⁷

Standards for suppliers often serve as a barrier to entry for smaller American companies looking to export. US auto companies that wanted to sell to Korea's market before the FTA often faced strict safety standards, limiting their business opportunities, particularly for firms that were exporting smaller volumes.⁸ Another obstacle addressed in FTAs is the arbitrary use of

⁵ OECD – WTO <http://www.oecd.org/industry/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm>

⁶ ITC: U.S. – Korea FTA effect on SMEs <http://www.usitc.gov/publications/332/pub4393.pdf>

⁷ ITC: U.S. – Korea FTA effect on SMEs <http://www.usitc.gov/publications/332/pub4393.pdf>

⁸ http://www.whitehouse.gov/sites/default/files/email-files/South_Korea_Trade_Agreement_Overview.pdf

environmental standards for protectionist purposes. Provisions in the FTA seek to ensure that environmental standards answer genuine problems.⁹

We should expect similar positive outcomes, on a much larger scale, if the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) are concluded. Here are some examples. “Trade facilitation” will be an important payoff. This is the technical jargon for agreed measures that cut red-tape at customs ports and upgrade hard and soft infrastructure. Another payoff, both in the TPP and TTIP, will be convergence of standards, or mutual recognition of standards, so that small business firms can sell their goods and services abroad without expensive modification. Improving the channels for online marketing will be another benefit. A new study by the World Bank shows how the “eBay effect” lowers the negative impact of distance on international sales by some 65%.¹⁰ The alliance between online marketing firms, such as eBay, and express carriers (FedEx, UPS, DHL) will make it much easier for small business firms to reach foreign markets.

Actions outside FTAs to Help Small Business

Unlike the situation two decades ago, US infrastructure is far from the world’s best. The United States is well behind several Asian and European countries – meaning that our roads, ports and airports are second class. These deficiencies adversely impact US exports. Small business exporters are further hindered by the scarcity of finance. A report from the Small Business Administration’s Office of Advocacy concluded that small business relies more than big business on bank finance, but that credit conditions have been tight.¹¹ For some small business firms, export controls are an important issue. The vice president of international affairs at the Aerospace Industries Association, Remy Nathan, said “The existing web of regulations spans across multiple agencies and is so complex that some smaller firms are hesitant to attempt exports for fear they might break the law.”¹²

⁹ http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm4_e.htm#TRS

¹⁰ World Bank: How eBay Reduces Trade Costs http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2012/10/25/000158349_20121025161729/Rendered/PDF/wps6253.pdf

¹¹ SBA Credit Availability Effects on Small Business [http://www.sba.gov/sites/default/files/files/rs404tot\(3\).pdf](http://www.sba.gov/sites/default/files/files/rs404tot(3).pdf)

¹² <http://thehill.com/blogs/regwatch/business/296035-obama-forges-ahead-with-overhaul-of-export-controls>

These subjects call for action in the United States, under Congressional leadership. Shortcomings that curtail America's export potential will not be cured by event the most ambitious FTA; they require reform here at home.

Thank you, Chairman Graves and members of the committee. I am happy to answer questions.