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## COMMUNICATION FROM CANADA

### Working to Ensure Benefits from the GATS for Members' Small and Medium Sized Enterprises (SMEs)

The following communication, dated 22 February 2005, from the delegation of Canada is being circulated to the Members of the Council for Trade in Services.

#### I. INTRODUCTION

1. Small and medium enterprises (SMEs) play a crucial role in the domestic economies of all WTO Members. They are often disproportionately affected by barriers to trade. A strong outcome in the services negotiations that will encourage and facilitate SME participation in services trade is a priority for Canada. Canada's bilateral discussions on the subject have confirmed that this is an objective that is strongly shared by other WTO Members, developing country Members in particular.

2. As WTO Members prepare their revised services offers, and as the services request-offer process intensifies over the coming year, we encourage WTO Members to give consideration to the GATS-related needs of SMEs – consideration that reflects their important, but often unrecognized contribution to our domestic and collective growth and prosperity.

#### II. IMPORTANCE OF SMEs

3. Small and medium enterprises are the driving force of both developing and highly industrialized economies. They are the primary source of innovation, growth and new employment. In Canada, SMEs contribute 43 per cent of Canada's private sector GDP, employ 6 in 10 Canadians, and have created 80 per cent of new jobs annually over the past 21 years. In Canada, the vast majority of services firms (86 per cent) are small enterprises employing fewer than 50 people. In Organisation for Economic Cooperation and Development (OECD) countries, SMEs make up over 95 per cent of enterprises, a large number of which are services firms. In OECD countries, SMEs account for 60 – 70 per cent of employment, and are responsible for over 90 per cent of new job creation. Worldwide, the importance of SMEs is even more pronounced. A recent UNCTAD study found that SMEs usually comprise about 99 per cent of all enterprises worldwide, account for 50 per cent of manufacturing output, from 44 – 70 per cent of employment, and play an especially important role in new job creation.

#### III. SME PARTICIPATION IN SERVICES TRADE

4. Given their contribution to economic growth and development, SMEs have generally been considered under-represented in world trade. Recent research suggests, however, that SMEs are much

more active in services trade than was previously thought. In Canada for example, a recent study by Industry Canada's Small Business Policy Branch reveals that 85 per cent of Canadian exporters are small businesses (fewer than 100 employees). Canadian SMEs are also indirectly involved in services trade in industries such as storage, transportation, finance, communications, and a myriad of other activities that are essential to trade. A recent survey by the Canadian Federation of Independent Business found that the majority of Canadian SMEs strongly favour trade liberalization.

5. Worldwide, a recent OECD study found that SMEs also predominate in services related to computer software and information processing, research and development, marketing, business organization and human resource development. Furthermore, SME market share in these sectors has been growing due to the global growth in outsourcing and the advent of new technologies. Advances in technology will continue to increase SMEs global reach. Now is an opportune time to consider what WTO Members can do in the GATS negotiations to help services SMEs access international markets.

#### **IV. BARRIERS TO SME PARTICIPATION IN SERVICES TRADE**

6. Many of the problems faced by SMEs have been previously raised in the GATS context. For instance, in communications from Canada in March 2001 (S/CSS/W/49) the United States in October 2002 (TN/S/W/5), and from Mauritius in October 2002 (TN/S/W/8). SMEs face cost disadvantages compared to larger enterprises in accessing the finance, information and technology necessary to tap into new markets. Furthermore, discriminatory, non-transparent regulatory environments create market access barriers for firms of any size, but often have a disproportionate affect on SMEs. Due to financial and human resource constraints, smaller enterprises find it relatively more costly than larger firms to "jump over" these regulatory hurdles to enter into new markets, and sustain their activities there. A recent OECD study, submitted at the June, 2004 Istanbul Ministerial Conference on Small and Medium Enterprises, found that the complexity and differences in the regulatory systems and business environment between countries is a major factor impeding SMEs contribution to the global economy. Reducing the time and financial expense that SMEs spend navigating regulatory environments is one of the most important outcomes the GATS negotiations can provide for SMEs.

7. We must keep in mind that some of the determinants of SMEs higher costs relative to larger enterprises, such as inadequate access to low-cost financing<sup>1</sup>, reduced ability to capture gains from vertical integration and economies of scale and scope, and smaller domestic markets for their goods and services are domestic policy challenges that cannot be directly addressed within the scope of the GATS. There are, however, practical, concrete ways that GATS rules and commitments can reduce the costs of SMEs' trade in services.

#### **V. MAXIMIZING THE BENEFITS THE GATS DELIVERS TO SMEs**

8. WTO Members can create a more supportive environment for SME service exporters by giving consideration to the specific needs of SMEs during the GATS request offer process:

- 1) Members should work towards an ambitious outcome in sectors where the greatest export potential for services SMEs lies, such as computer and related services, research and development, marketing and various business services.
- 2) Members must also work towards an ambitious outcome in key infrastructure services. Access to low cost infrastructure services helps SMEs remain competitive. Mauritius' paper on small economies (TN/S/W/8) outlines some of the difficulties that SMEs have,

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<sup>1</sup> Research has demonstrated that this is not the case for all countries.

in small economies in particular, accessing core services such as transport, financial and telecommunications services at competitive rates.

- 3) From a modal perspective, research suggests that modes 1 and 4 are the most cost-effective modes of delivery for SMEs. As Chile, India and Mexico pointed out in their June 2004 communication on mode 1 liberalization [JOB(04)/87], the computerization of services, the rapid increase in telecommunications capacity and the steep decline in telecommunications prices makes it possible to transmit services across countries at lower costs. As the communication pointed out, this cost-advantage is particularly important for SMEs. Additional commitments on mode 1 would help SMEs take advantage of new technologies. The planned 2005 Symposium on Cross-Border Supply of Services is a welcome step in this direction.

Generally, WTO Members have made mode 4 commitments on intra-corporate transferees (not necessarily for all categories), a fewer number of commitments for business visitors, and only a small number of commitments for professionals, most of which are linked to commercial presence. SMEs would benefit from additional commitments by Members on business visitors, contract service suppliers and independent professionals. Current mode 4 horizontal commitments may be undermined by various limitations for economic needs tests (ENTs), and non-transparent and discriminatory requirements tied to licensing and certification requirements. SMEs would also benefit from greater transparency in mode 4 commitments.

Inter-modal linkages, in particular mode 3 linkages are also worthy of consideration. A 2004 OECD study found that Foreign Direct Investment is an important vehicle by which SMEs access international markets. FDI also fosters inclusion of SMEs in international supply chains, as many SMEs are domestic suppliers of intermediary inputs to products exported by larger firms.

- 4) WTO Members must also work towards the elimination of specific regulatory "measures" that are particularly problematic for SMEs. Regulations that require that services be supplied through commercial presence or through local partnership are some of the most visible measures that discriminate against SMEs. These types of requirements force substitution across modes, limiting market access to smaller firms to whom commercial presence is not financially feasible. Other restrictions listed in Members' GATS schedules that may disproportionately affect services SMEs include taxes that are specific to foreign service suppliers, restrictions on remittances, capital transfers and currency conversion, residency and nationality requirements, registration requirements and fees that are specific to foreign companies, and technology transfer requirements.
- 5) Finally, WTO Members must work to ensure that the GATS plays its part in fostering a simple, transparent and stable regulatory environment. SMEs do not have as many resources at their disposal to navigate complicated regulatory environments. Members should work to promote regulatory transparency within country schedules, by clearly and unambiguously listing market access and national treatment restrictions. Members should also work towards making information regarding domestic regulatory frameworks as inexpensive, accessible and up-to-date as possible. Canada's March 2001 initial negotiating proposal on regulatory transparency and predictability (S/CSS/W/47) outlined the key transparency elements of the Government of Canada's Regulatory Policy. Canada encourages an exploration of current best practices to determine where existing GATS transparency provisions can be enhanced so as to promote more transparent regulatory practices.

## **VI. CONCLUSIONS**

9. SMEs are the base for a strong, dynamic economy. Technological changes (internet-based electronic commerce in particular) will continue to increase SMEs' ability to compete internationally. As we move into a more refined stage in the request-offer process, and as the negotiations intensify leading up to the Hong Kong Ministerial Conference, Canada encourages WTO Members to consider ways in which regulatory measures that unnecessarily constrain the global reach of services SMEs can be eliminated. Furthermore, Canada hopes this communication will stimulate constructive dialogue as to other steps that can be taken within the GATS context to promote a more transparent, facilitative regulatory environment for services SMEs.

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