“Opening the World of Export Opportunity to U.S. Small Businesses”

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The Cato Institute
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On “Small Business Exports in the Current Economic Climate.”
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Chairwoman Velázquez, Ranking Member Chabot, and other members of the House Small Business Committee, thank you for inviting a scholar from the Cato Institute to testify a today’s hearing on “Small Business Exports in the Current Economic Climate.”

Expanding Exports a Bright Spot for Economy

Globalization is a fact of life in 21st century America, and America’s small businesses should be allowed to take full advantage of its opportunities. Since 1990, the share of U.S. GDP that Americans have earned abroad though exports of goods and services and earnings on foreign investment has jumped from 12 percent to 17.4 percent. That is the highest ratio of exports to GDP in our history. Americans have never earned or spent a higher share of our income in the global economy than we do today. Three quarters of the world’s spending power and 96 percent of its people live outside the United States. This represents a huge potential market for U.S. producers in general and hundreds of thousands of American small businesses in particular.

Our growing engagement in global markets is one of the bright spots in the U.S. economy today. As the housing and financial sectors have tanked, exports and earnings on foreign investment are booming. While the economy as a whole has slowed dramatically, exports of goods and services jumped by 12.6 percent last year, and earnings on U.S. investments abroad soared by 20 percent. The healthy growth in exports has continued into the first quarter of this year, according Commerce Department data released just this week. That expanding opportunity to serve foreign markets has allowed U.S. companies, including small businesses, to better weather the current slowdown.

Driving this increase in demand for U.S. exports has been strong growth abroad, especially in emerging markets. The global poverty rate has been cut by more than half since 1981, with much of the credit is due to market-reforms in developing countries, including unilateral trade liberalization. Hundreds of millions of people have joined the rising middle class in China, India and the more reform-minded countries elsewhere in Asia, Latin America, Africa, and the Middle East. American companies and workers are reaping the benefits of expanding global trade and development.

Small Businesses Reaching Global Customers

Opponents of free trade dismiss it as a policy that only favors Fortune 500 companies. That claim is becoming more false every day. A quarter of a million U.S. companies export to foreign markets, the large majority of them small and medium-sized enterprises

(SMEs) that employ 500 or fewer workers. According to the U.S. Chamber of Commerce, more than 230,000 SMEs now account for nearly 30 percent of U.S. merchandise exports. The number of such companies exporting has more than doubled since 1992.

This growth has been propelled not only by the expansion of global trade generally but also by technological developments especially favorable to smaller exporters. On the cutting edge of this development has been the spread of the Internet and e-commerce. There are now more than 1.3 billion Internet users in the world today, and the number is growing rapidly. Of those, 85 percent shop online. With the assistance of delivery services such as FedEx and UPS, small businesses are able to reach global markets without the daunting expense of establishing sales teams and distribution networks in foreign countries. The Internet has also facilitated the slicing up of global supply chains, creating more opportunities for smaller U.S. companies to find profitable niches as suppliers for larger multinationals.

One of the most important and fastest growing markets for America's small-business exporters is China. Last year, Americans exported $65 billion worth of goods to China, making it our third largest customer for U.S. goods in the world, behind only our NAFTA partners Canada and Mexico. Since China's entry into the WTO in 2001, U.S. goods exports to China have grown at an annual compound rate of 22.6 percent. That is triple the growth rate of U.S. exports to the rest of the world. China is now a major market not only for U.S. agricultural products, but also for plastic materials, chemicals, industrial machines, semiconductors, telecommunications equipment, and computer accessories.

Small and medium-sized U.S. companies are basking in this export success. In 2004 (according to the most recent figures we have), 19,210 SMEs in the United States were exporting to China. That is more than six times the number that were exporting in 1992. The share of U.S. companies exporting to China that are small or medium-sized enterprises has grown during that time from about three-quarters to more than 90 percent. SMEs accounted for 35 percent of U.S. merchandise exports to China in 2004, a higher share than their 29 percent share of exports overall. Board any flight from the United States bound for China and you will probably be sitting near somebody representing a small-sized U.S. company heading off to buy and sell in the world's fastest growing major market.

Despite loud complaints from certain U.S. producers, the undervalued yuan does not appear to have dampened the ability of U.S. companies—large, small or in between—to sell in China's expanding market. If Congress enacts legislation that ignites a trade war with China, small U.S. exporters will be among the front-line casualties.

An Agenda to Promote Small Business Exporters

What can Congress do to help promote the ability of small U.S. companies to compete successfully in global markets?

Congress should seek to lower trade barriers to our own market so that U.S companies can access raw materials, industrial supplies, and capital machinery at the lowest possible global prices. A more open U.S. market also feeds back into more export opportunities in foreign markets. Foreign producers who can sell more freely in the U.S. market thus earn more dollars in which to spend on U.S. products and services for export. U.S. producers made more efficient by facing global competition are better able to gain and expand market share abroad. And reducing our own trade barriers sets a good example for other countries and helps to set the stage for trade agreements that also lower trade barriers abroad.

Far from calling a trade "time out," Congress should work with this administration and the next to approve comprehensive trade agreements to abolish trade barriers and promote two-way foreign investment. Agreements to reduce trade barriers and facilitate investment certainly do benefit big U.S. multinationals—and no apology is necessary for that—but they benefit smaller U.S. companies just as much if not more. Those agreements benefit smaller U.S. exporters in three important ways.

First, trade agreements help to reduce red tape and increase transparency. Small businesses lack the resources and foreign business partners available to large companies to navigate through opaque customs and legal systems to reach their customers. Numerous fees and other non-tariff barriers that can be no more than a nuisance to large multinationals can be deal-breaker for small companies. Trade agreements streamline rules, reduce non-tariff barriers and provide arbitration procedures so that even small U.S. exporters can successfully participate in foreign markets. As a new study by my Cato colleague Daniel Ikenson found, improving "trade facilitation" can do more to bolster U.S. trade than actual tariff cuts.[1]

Second, trade agreements open up opportunities for small U.S. exporters to compete for foreign government contracts. Previous and proposed trade agreements guarantee U.S. companies a fair shake at the important government procurement market. Such agreements can help to lower the threshold at which contracts must be put out for competitive bid, ensuring that even small U.S. companies can be part of the process. Some of those contracts—for roads, schools, clinics, distance learning, and medical equipment, for example—can be ideally suited to smaller U.S. companies.

Third, trade agreements lower tariffs and other barriers to trade that are more difficult for small exporters to work around. Many large multinationals have the option of relocating production facilities to foreign affiliates, circumventing border barriers. Most SMEs, in contrast, export from a single domestic location. The reduction and elimination of tariffs allows them to export from their domestic facilities without facing barriers that can often be discriminatory and prohibitive.

Opportunities in South Korea, Panama, and Colombia

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[1] Daniel Ikenson, "While Doha Sleeps: Securing Economic Growth through Trade Facilitation," Cato Trade Policy Analysis no. 37, June 17, 2008, available at www.freetrade.org.

The 110th Congress has the opportunity right now to enact three important trade agreements—with Colombia, South Korea, and Panama—that will help small U.S. companies boost their exports. All three of these agreements would reduce and eliminate tariffs on U.S. exports to each of those markets while guaranteeing fair treatment for U.S. companies that investment abroad. They would streamline customs procedures, enhance transparency, and open up government procurement markets for bid by U.S. companies of all sizes. These agreements would allow thousands of small business in the U.S. to export to these markets for the first time.

U.S. small businesses are already exporting to all three of those markets, although they currently face trade barriers that are significantly higher than those imposed by the United States.

- In South Korea, nearly 17,000 small and medium-sized U.S. companies already export to what is America's seventh-largest market abroad. SMEs account for almost a third of U.S. exports to Korea. The agreement would be especially helpful for U.S. exporters of electronics, 94 percent of them SMEs.
- In Panama, 5,600 U.S. companies are already exporting there, with 80 percent of them small and medium-sized enterprises. Since 2002, U.S. exports to Panama have been growing more than twice as fast as exports to the rest of the world.
- In Colombia, 7,705 small and medium-sized U.S. companies are already exporting, accounting for 35 percent of American goods sold in that country. Almost all Colombian goods already enter the United States duty free because of the Andean Trade Preferences Act. The U.S.-Colombia trade agreement would eliminate Colombian tariffs that currently range as high as 35 percent, delivering the "level playing field" so many members of Congress say they want. According to the U.S. International Trade Commission, the agreement would boost U.S. exports to Colombia by $1.1 billion a year. American small businesses are ready to claim a big slice of that expanding pie.

Say 'No' to Trade Barriers and Export Subsidies

What U.S. small businesses do not need are higher trade barriers to our domestic market or more federal subsidies to supposedly promote exports or foreign investment. Punitive tariffs against a country such as China would threaten to drive up costs for U.S. small businesses that import intermediate products from that country. Escalating trade tensions would also jeopardize export opportunities in growing markets abroad. Antidumping orders and other tariffs against such imports as steel or agricultural commodities drive up costs for domestic producers, many of them small businesses, who use those imports in their final products.[2] For the same reasons, a weak U.S. dollar, while benefiting certain

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[2] For the impact of steel tariffs, see Daniel Ikenson, "Ready to Compete: Completing the Steel Industry's Rehabilitation," Cato Trade Briefing Paper no. 20, June 22, 2004, pp. 5-6; for the impact of agricultural trade barriers on U.S. producers, see Daniel Griswold, Stephen Slivinski and Christopher Preble, "Ripe for Reform: Six Good Reasons to Lower U.S. Farm Subsidies and Trade Barriers," Cato Trade Policy Analysis no. 30, September 5, 2005, pp. 4-6.

U.S. exporters, has driven up production costs that U.S. small businesses pay for imported energy, parts and capital machinery.

Nor do U.S. small businesses need a larger share of federal subsidies for international trade. While small and medium-sized companies do qualify for such programs as the Export-Import Bank and the Market Access Program, they account for a small dollar share of total federal support.

U.S. companies do not need federal subsidies to compete effectively in global markets. Our research at Cato has shown that U.S. exporters have outperformed their counterparts in Great Britain, Germany, France, Canada and Japan even though the share of U.S. exports receiving government support is much lower than exports from those countries. Most U.S. export subsidies go to firms that do not experience subsidized competition abroad. [3] U.S. and global markets are currently awash in private capital ready to finance new trade and investment opportunities. Federal export subsidies do not promote more exports but only reshuffle the export pie in favor of larger U.S. companies, crowding out smaller exporters.

If Congress and the administration want to increase opportunities for U.S. small businesses to compete and thrive during the current, challenging economic climate, they should work together to reduce barriers to international trade and investment whether in the United States or in other countries.

[3] Aaron Lukas and Ian Vásquez, "Rethinking the Export-Import Bank," Cato Trade Briefing Paper no. 15, March 15, 2002.