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**“Statistical Model and Regional
Economic Development in West China:
Trade, Investment and the WTO”
International Conference
Thesis Collection**

**“统计模型与中国西部区域经济开发：
贸易、投资和WTO”**

国际会议论文集

王文学 纪宏 主编



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Aims of the Conference

The World Trade Organization (WTO) membership, regional economic integration (REI) and such Asian free trade agreements (FTAs) as ASEAN +3, ASEAN +5 (ASEAN 3 + Australia and New Zealand) and Australia-China are expected to enhance trade, investment, development and growth, and as a policy outcome, to reduce poverty in China. While a number of nationally and internationally (eg, ODA) funded projects have devoted to study this trend in China in recent years, only very limited work has been carried out on its impact at the regional level, for example, in the Central West and South West or rural and inland regions of China. These regions however are still in the under-developed stage, have about 200 millions poor people (on World Bank estimates), and currently, of national and international high-priority for economic development. The Seminar is proposed and organized by the Renmin University of China (RUC) and organized by Department of Statistics, Capital University of Economics and Business (CVEB) in Beijing in October 10 to 11 in 2005 with sought assistance from AusAID (The Australia Government's overseas and programme) to assist China: (1) to develop an understanding and acquire skills to manage important issues in WTO membership and the ASEAN +3, ASEAN +5 or the proposed Australia-China or ASEAN + India (in which Australia has a very keen interest) FTAs, and (2) how to use these bilateral and multilateral FTAs/REI to contribute to an appropriate design and effective implementation of policies to promote and sustain economic development in these regions in particular and in China in general.

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SME Capacity Building, Clustering and Regional Competitiveness

Charles Harvie

(University of Wollongong, Australia 2522)

E-mail: charles_harvie@uow.edu.au

Abstract: In conjunction with increased economic integration of East Asia and APEC, there are increased recognition by regional governments of the potential for a substantial increase in the participation by small businesses in the generation of regional income, employment, exports, investment and expanded economic growth. Advances in information and communication technology add credence to this potential. In addition, developing economies are especially seeing small businesses as potential instruments for the alleviation of poverty and regional development. The small and medium enterprise (SMEs) sector can play a key role in the attainment of such objectives. This paper reviews the contribution of the SMEs sector to the growth and development of the East Asian economies, and their increasing importance in the attainment of a sustained recovery of the region. It also identifies: barriers to their development; key factors essential for their capacity building; strategies to enhance their competitiveness in the global marketplace; key components relating to their export success; and their role and importance in facilitating regional economic development, reducing income inequality, and empowering regional involvement in the global economy.

1. Introduction

SMEs can play a key role in economic growth and equitable development in developing countries, whose contribution to employment generation, output, exports, poverty alleviation, economic empowerment, and wider distribution of wealth and opportunities for developing countries. However, this potential is often not realized due to a number of factors relating to the size of SMEs, their isolation of locational (regional) operation, and in terms of interaction with other similar sized enterprises. Hence, there is the potential that with closer cooperation between SMEs and relevant supportive institutions.

One important route through which SMEs can address some of the previous problems as well as enhancing their competitiveness is network^①. By coordinating their activities, enterprises can collectively achieve economies of optimal scale in the use of machinery and pool production capacities to meet large-scale orders. Inter-enterprise cooperation also enables SMEs to specialize in their core businesses and give way to an external division of labor thereby improving their efficiency in production. Joint work also encourages enterprises to learn from each other, exchange ideas and experience to improve product quality and take over more profitable market segments.

However, evidence from developing and developed countries shows that cooperative relations and joint action are more likely when enterprises operate in close geographical proximity, within a region, and share business interests such as markets for products, infrastructure needs or challenging external competition. Within such clusters^② enterprises' joint initiatives are stronger, more cost effective due to

① A network is a group of firms that cooperate on joint project development complementing each other and specializing in order to overcome common problems, and achieve collective efficiency and penetrate markets beyond their individual reach. Whether horizontal or vertical, networks can be developed within, or independently of, clusters.

② Clusters are sectoral and geographical (regional) concentrations of enterprises that produce and sell a range of related or complementary products and, thus, face common challenges and opportunities.

shared fixed costs and easier to coordinate, with proximity fostering mutual knowledge and trust. Small companies tend to concentrate in a core of well-known competencies, while they outsource components from other small companies. Within a true cluster, there is a capacity for exploration, for experimenting new processes, new products, or new markets. It is also important of SMEs support systems and institutions concerned with aspects such as the regulatory environment, logistics, financing, and telecommunications. There is ample evidence that SMEs operating in the same or in related industrial sectors tend to cluster close to one another.

The paper proceeds as follows. Section 2 briefly provides background information on the role and significance of the SME sector in the economies of East Asia and APEC more generally. Section 3 discusses the major barriers to the further development of the SME sector and key areas for capacity building that will enable this sector to make the maximum gains from regional trade and investment development. Section 4 discusses the important role of government in supporting the development of SMEs. Section 5 discusses SMEs and regional competitiveness strategies. Section 6 presents the major conclusions and policy implications from this paper.

2. Background—the Role and Significance of the SME Sector in East Asian Economic Development^①

SMEs have been recognized as a priority area for the East Asian economies, and the need to develop more adaptable and flexible economies and business sectors, has resulted in increased emphasis on the development of the SME sector.

Although SMEs are important across the region, there are considerable differences in the role of SMEs in various economies. For example, SMEs play a larger structural role in Taiwan(China), China,

^① This section draws extensively upon Hall (1995).

Japan, Thailand and Vietnam where they contribute over 70 percent of employment, than they do in Indonesia or Malaysia where they contribute only around 40 percent. In addition, the contribution of the SME sector to exports, and hence the extent of their global integration, also varies widely. They are relatively more export oriented in China, Korea and Taiwan(China) than they are in Japan, Indonesia, Thailand, Malaysia and Singapore. Similarly, the dynamic role that SMEs have played has varied between the various countries and regions. More recently in the case of China, and somewhat reluctantly in the case of Vietnam, entrepreneurial private SMEs and rural enterprises^①, during the early part of the reform process, have been pivotal in the transition process from a planned to market oriented economy.

They have contributed to more efficient resource allocation, the marketisation of these economies, and are increasingly important in creating new jobs and in expanding exports. Recognizing this requirement, the government has been actively assisting in this process.

Table 1 summarizes key common features, differences and policy issues, in the profile of SMEs in East Asia/APEC that have been discussed in this section.

Table 1 A summary profile of SMEs in East Asia/APEC

	Key features	Regional differences and policy issues
Number of enterprises	1. There are about 20 to 30 million SMEs in East Asia. 2. They account for 98% of all enterprises. 3. Micro-enterprises account for about 73% of all private sector enterprises. 4. On average, there are about 85 people for every SME.	1. Most of the SMEs are in China (8 million) and Japan (5 million) and Korea (2.6 million), which together have 70% of the SMEs in East Asia. 2. In developed economies, there are only about 20 people per SME, but the ratio is above 100 in the developing economies, especially in China, Vietnam, Philippines and Indonesia.

① The so-called township and village enterprises (TVEs).

(Continued)

	Key features	Regional differences and policy issues
Employment	5. SMEs employ about 60% of the private sector workforce, and 30% of the total workforce. 6. Micro-enterprises employ about 21% of total APEC wide employment. 7. Over 95% of enterprises employ less than 100 people, and over 80% employ less than 5 people. 8. SMEs contribute about 70% of net employment growth. 9. SMEs provide about 80% of employment in the services sector, and about 15% in the manufacturing sector. 10. Women make up about 30% of employers/self employed in APEC mainly in micro-enterprises	3. In developing economies (below about US\$15 000 per head income), SMEs employ about 75% of people, above \$15 000 the level is closer to 50%. Japan is a major exception, Japan's SMEs employ around 80% of the workforce. 4. More developed economies seem to have more medium sized SMEs and they play a greater role. Developing economies seem more likely to have a " missing middle". 5. In developed economies, most of this growth probably comes from fast growth firms, in developing economies, a higher proportion probably comes from net start ups.
Output measures (sales, value added etc.)	11. SMEs contribute about 50% of sales, value added or output.	6. The contribution varies from lows of 15% (Singapore) and 30% (Australia) to about 60% for most other economies.
Exports	12. SMEs generate about 30% of direct exports (US\$930 billion in 2000), much less than the SME contribution to employment (about 60% to 70%) or output (about 50%). 13. SMEs contribute indirectly to trade through supply chain relationships with other firms. SME contribution to total trade could rise to 50%.	7. SME exports figures are difficult to verify, but they range from about 5% or less (Indonesia) to around 40% (Korea) of total exports. 8. Tariff cuts have increased total APEC member trade, but the SME contribution to direct exports has remained static or declined. Reductions in tariffs have not benefited SMEs, more emphasis needs to be put on tackling non tariff barriers if SMEs are to benefit from trade expansion.
FDI	14. SMEs generate about 50% of cases of FDI, but only less than 10% of value of FDI.	9. Korean, Japanese and Chinese Taipei SMEs contribute most FDI originating in the East Asian region.

(Continued)

(Continued)

	Key features	Regional differences and policy issues
Entrepreneurial engine, international potential, and the new economy	15. SMEs already contribute the bulk of growth, and SMEs could make a much bigger contribution to the Asian regional economy if efforts were made to address impediments to SME internationalization. This could add as much as \$1.18 trillion in trade over a 5-year period.	10. The developing economies need to create about 50 to 70 million more SMEs if they are to achieve "benchmark" levels of SME activity.
	16. SMEs move towards services and away from agriculture and manufacturing.	11. To achieve maximum gain from trade it is essential to improve governance, building capacity, reducing transaction costs, promoting further liberalization, addressing non tariff barriers, increasing internet access and facilitating trade and investment to improve the capacity of SMEs to export.
		12. Capacity building includes: access to finance; improved professional skills (IT, management, accounting and entrepreneurship); improved business infrastructure; removal of trade barriers that particularly adversely affect SMEs.
		13. E-commerce use of SMEs lags larger enterprises. Important for cost saving and growth potential. Usage of technology a problem due to: set up and usage costs; lack of adequate infrastructure and IT skills.

Source: Hall (2002) supplemented by information from APEC (2002).

3. SME Capacity Building

3.1 General Capacity Barriers

Building capacity, improving governance, reducing transaction costs, promoting further market liberalisation, addressing non-tariff barriers, increasing internet access, and facilitating trade and investment are all directly relevant to improving the capacity of small businesses to

exploit export market opportunities and for their regional growth.

At the Ottawa meeting of APEC in September 1997, for example, five key areas of importance to the capacity building of SMEs were emphasized. These are access to: markets, technology, human resources, financing and information.

3. 1. 1 Access to markets

Despite cuts in average tariffs in APEC from 12 percent in 1995 to 8 percent in 2000 that resulted in an estimated growth rate in merchandise exports of 4. 7 percent per annum during 1995 ~ 2000, there is a perception that small businesses have been unable to fully exploit opportunities to export. The SME contribution to direct exports has remained static or declined. Reductions in tariffs have not benefited SMEs, and more emphasis by regional governments needs to be put on tackling non-tariff barriers (customs procedures, mobility of business people, standards of labeling requirements, access to finance, recognition of professional qualifications, consumer protection particularly regarding on line transactions, and intellectual property rights) if SMEs are to benefit from trade expansion and to enhance their exporting capacity.

3. 1. 2 Access to technology

In a knowledge-based economy, applications of information and communication technology can be a great leveler for SMEs. However, when SMEs have limited access or understanding of these technologies, their prospects of acquiring and utilizing these for their benefit is reduced.

3. 1. 3 Access to human resources

Human resource development for SMEs requires a comprehensive approach, including social structures and systems such as broad educational reforms; encouragement of entrepreneurship, business skills acquisition and innovation in society; mechanisms for self learning and ongoing training and enhancement of human resources; and appropriate governmental support programs. Among small and micro enterprises, shortage and cost of skills in information technology is a major hindrance to business growth.

3. 1. 4 Access to financing

Many SMEs lack awareness of financing resources and programs

available from commercial banks and other private sector and government sources, and that they have difficulty in defining and articulating their financing needs. Financial institutions need to be responsive to their needs and for continuing simplification of trade documentation.

3.1.5 Access to information

Accurate and timely information on, for example, market opportunities, financial assistance and access to technology is crucial for SMEs to compete and grow in a global market environment. This is an important role that both the government and relevant business organizations can play.

In addition to these key areas for capacity building, another relates to the development of business networks, including the development of strategic alliances and joint ventures.

Inter-firm networking. A network is a group of firms using combined resources to cooperate on joint projects. Networks have come to encompass agreements with research bodies, education and training institutions and public authorities, moreover, can allow accelerated learning, can allow the sharing of overhead costs and the exploitation of specific scale economies present in collective action. Furthermore, networks need not to be geographically concentrated. Once trust among participants is established, and the strategic direction agreed, operation dialogue could be facilitated through electronic means.

Innovation. Small firms account for a disproportionate share of new product innovation despite their low R&D expenditures (Acs and Audretsch, 1990). In addition, they have also been innovative in terms of improved designs and product processes and in the adoption of new technologies. Scherer (1988) has suggested that SMEs possess a number of advantages relative to large firms when it comes to innovative activity. First, they are less bureaucratic than highly structured organizations. Second, many advances in technology accumulate on a myriad of detailed inventions involving individual components, materials and fabrications techniques. Third, it is easier to sustain high interest in innovation in small organizations where the links between challenges, staff and potential rewards are tight.

3.2 Barriers to SME Development in a Developing Transition Economy—the Case of Vietnam

3.2.1 Access to Land

SMEs have experienced major difficulties in accessing land. About 70 percent of transactions in land use rights take place in the unofficial market, where SMEs lease land from SOEs, non state enterprises and households. Obtaining land in such a way, however, could result in punishment of the SME, and cannot serve as a basis for sustained growth of the business. The current situation relating to land use rights is clearly acting as a hindrance to the growth and development of new SMEs as well as the growth of existing SMEs. A new Land Law that is simple, transparent, and enables the speedy transfer of land ownership/usage will be essential for the future growth of the SME sector.

3.2.2 Access to Finance

A survey of SMEs conducted in 1999 by the Vietnam Chamber of Commerce and Industry (VCCI) found that: 55 percent of enterprises had difficulty in obtaining capital; 67.5 percent of enterprises had to borrow from relatives and friends; 25 percent of enterprises had to deliver materials in advance; only 42.5 percent of enterprises borrowed from the banks; and 20 percent of enterprises borrowed from other financial organizations (VCCI, 1999). Some surveys of SMEs suggest that reliance on personal savings, friends and family, and retained earnings accounted for 85 percent of total financing, with financial intermediaries accounting for the rest (15 percent). Other surveys of SMEs by government management agencies and other organizations also point out that the share of bank loans allocated to non-state enterprises has tended to increase, but not in accord with their number and their contribution to GDP.

Difficulty in accessing financial resources by SMEs has partly resulted from the obstacles created by some of the policies and regulations on capital mobilization. First, the majority of external resources, such as Foreign Direct Investment and Official Development Assistance, have been allocated to the state sector. Second, there are still irrational regulations that seriously hamper the capital mobilization of SMEs. For example, the regulations on short-term credit issued by the State Bank