

# German SMEs and the Transatlantic Trade and Investment Partnership: What drives the formation and representation of their preferences in the TTIP negotiations?

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## Abstract

Although the European Commission and business associations frequently underline the benefits of a potential Transatlantic Trade and Investment Partnership (TTIP) for small and medium-sized enterprises (SMEs), there is little visible evidence that SMEs broadly engage in lobbying to support an agreement.

This initial study seeks to generate hypotheses on the question how German SME preferences are formed and represented in the TTIP negotiations. It draws on earlier theoretical work on the formation of trade preferences of business actors as well as the literature on strategies of interest groups on EU policy-making. To derive hypotheses, it builds on semi-structured expert interviews with German SME owners, business association representatives as well as an analysis of TTIP position papers of German cross-sectoral SME associations. Because of their large export activities and the frequently claimed organisational capacities of German business associations, German SMEs are likely to have stronger access to the TTIP negotiations than SMEs in other countries.

While preferences are a necessary precondition for interest representation, not all German SMEs seem to have formed preferences on TTIP. This study hypothesises that SMEs are unlikely to form trade preferences if they view internal capacities as bigger export barriers than trade policy barriers or if they view their interests aligned with the interests of large firms. At the same time, SMEs are likely to form trade preferences if their owners are active in business associations. It further hypothesises that business associations can enhance the formation of trade preferences among SMEs if they communicate SME-specific issues and reduce uncertainty among SMEs by responding to publicly salient issues.

This study lends theoretical support to an endogenous formation of trade preferences. Besides, it contributes preliminary insights on SMEs to the literature on the effect of issue salience on interest group strategies.

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## 1. Introduction

In the controversies around the negotiations over a Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the United States, both the European Commission (subsequently: Commission) and various business associations put forward that a potential agreement will particularly benefit small and medium-sized enterprises (subsequently: SMEs). The negotiations over the free trade agreement between the EU and the US which were launched in 2013 have attracted substantial academic attention (e.g. Novotna, Telò & Ponjaert, 2015; Hamilton, 2014; Eliasson, 2014). Surprisingly little research has, however, been conducted on the representation of the interests of those firms which according to supporters of TTIP would benefit the most from a successful conclusion of the negotiations.

This initial study seeks to contribute to this gap. It aims at generating hypotheses on the question: How are German SME preferences formed and represented in the TTIP negotiations? In doing so, it seeks to address a striking puzzle: Although TTIP supporters underline strong economic benefits of TTIP for SMEs, there is little (*prima facie*) evidence that SMEs broadly engage in lobbying activities. Moreover, while according to a survey of the German Chambers of Commerce 70% of responding firms evaluate TTIP positively (DIHK, 2015: 19), a Commerzbank survey finds that only 15% of SME respondents expect business potential from TTIP (Commerzbank, 2014: 39).

For the purpose of this study, “SMEs” shall be defined in line with the usually applied definition of the Commission as firms with a maximum number of 250 employees and annual revenues of maximum €50 million (Commission, 2015). This definition needs to be differentiated from the mostly German-speaking area concept of “Mittelstand” which apart from firm size captures distinct management practices as well as the definition of “family businesses” which refer to a distinct ownership structure. In “Mittelstand” firms, the firm’s equity is (partially) owned by its management, i.e. the owner of a firm is also its chief executive officer and personally financially liable for strategic management decisions (Fischer, 2012). More than 99% of “Mittelstand” firms, however, meet the criteria of the Commission definition of SMEs (Fischer, 2012: 12). As this study considers the implications of these management practices and ownership structures, it shall use the terms “SMEs”,

“Mittelstand” and “family businesses” analogously although they certainly warrant stronger differentiation in future large-n studies.

The contribution of this initial study is to develop hypotheses how and under which circumstances SMEs form preferences on EU trade policy. The formation of preferences of SMEs is assumed to be a necessary precondition both for individual lobbying of SMEs on TTIP and an optimal adjustment of its provisions to the needs of SMEs. This study only focuses on German SMEs, “Mittelstand” firms and cross-sectoral associations representing SMEs. However, German SMEs provide an interesting case study as due to their large export activities and the frequently claimed organisational capacities of German business associations (e.g. Eising, 2007; Krickhahn, 1995) German SMEs are likely to have stronger access to the TTIP negotiations than SMEs in other countries. A better understanding of the challenges for the formation of trade preferences of SMEs is crucial to improve the involvement of SMEs in EU trade policy-making.

This paper in a first step reviews the existing literature on preference formation, trade policy preferences and determinants of lobbying strategies of interest groups. It then secondly outlines the methodological choice of this study to rely on in-depth expert interviews rather than large-n survey data, discussing both benefits and constraints. In a third step, it proposes hypotheses on factors that may facilitate and constrain the formation of trade preferences among SMEs. Lastly, this study it puts forward hypotheses on how business associations may influence the formation of trade preferences for and among SMEs.

## **2. Theoretical Background**

This chapter first delineates preferences from interests and strategies and then outlines major theoretical debates in the literature on preference formation and identification.

The difference between preferences, interests and strategies is well established in the rational choice literature (e.g. Vogel, 2012; Frieden, 1999; Milner, 1997). The preference of a firm refers to “its ranking of possible outcomes in a given environment” (Frieden, 1999: 41). On the one hand, preferences must be distinguished from interests. Interests are defined as “valued ends” (Woll, 2009: 31). They are assumed to be relatively stable over time. The interest of a firm is thus often stated as profitability (Trampusch, 2014; Woll, 2009). In this regard, a firm’s preference is understood as the outcome which the firm considers will best

realise its interest. On the other hand, preferences must be distinguished from strategies. The strategy of a firm is defined as “the translation of its preference into observable behaviour” (Frieden, 1999: 44). It is context-related and depends on the political context, institutional factors, opportunity structures as well as the resources of an actor.

The preference of a firm can be identified by assumption, induction through observation and deduction using prior theory (Frieden, 1999). There is a debate in the literature whether preferences are “exogenously” or “ex ante” given or “endogenously” formed and thus subject to change within given processes, dependent on changes in the strategic environment of an actor (Woll, 2009: 36). The literature assuming exogenous preferences argues that deduction is the analytically most satisfying approach as it avoids confusion between preferences and strategies (Frieden, 1999: 62). In this vein, Frieden underlines that the exogeneity assumption of preferences is analytically necessary to isolate the preferred outcome of an actor from influences of the environment of an interaction as well as the preferences of interaction partners (Frieden, 1999: 44). The large part of the theoretical literature on the trade preferences follows a deductive approach. Contributions deduce the preference of a firm on trade liberalisation dependent on its factor allocation, competitive advantage, productivity or position in global value chains (see chapter 3.1).

In contrast, the literature proposing endogenous preferences (e.g. Woll, 2009) argues preference changes are initiated by changes in the strategic environment of an actor. These changes in the strategic environment include changes in domestic or supranational legislation or regulation as well as changes in political processes. The literature on endogenous preferences analytically draws from both induction and deduction. Woll acknowledges that “empirical observation can help to note changes in behaviour only” (Woll, 2009: 37). She argues, however, that observation can nonetheless identify preferences and preference changes especially where a change in strategy becomes inconceivable with a previously deduced preference. This study seeks to explore how a theoretical approach building on endogenous preferences can enhance our understanding of the processes leading to preference change and formation in SMEs.

### **3. Literature Review**

#### **3.1 Trade Preferences**

This chapter discusses the existing literature on trade preferences. It then introduces major debates in the literature on interest group strategies in the EU to outline potential determinants of the representation of SME preferences in the TTIP negotiations.

Up to my knowledge, there is no study in the political science or economics literature which specifically investigates or delineates preferences of SMEs on trade policy. There are, however, a number of studies by international organisations, business associations and firms which rely on business surveys to formulate conclusions. All existing studies confirm that both tariffs and non-tariff barriers, in particular customs procedures and domestic regulations, restrict market access significantly (Commission, 2015; DIHK, 2015; UPS, 2014; OECD, 2006). SMEs were hereby in a particularly vulnerable position due to their size (OECD, 2006). With regard to transatlantic trade, different sanitary and phyto-sanitary standards (SPS) in the EU and the US, technical barriers to trade (TBT) as well as customs and border procedures the most important barriers to market access in the US for EU firms (Commission, 2015). Especially small firms also reported price-control measures, financing and distribution restrictions as trade barriers. The studies also note that there was some variation in the relative importance of these market access barriers across sectors (Commission, 2015; UPS, 2014). Nonetheless, among exporters across various product sectors, export regulations were the most “important” trade barriers for SMEs from various EU member states in trading with the US (UPS, 2014).

Findings are mixed, however, with regard to the importance of trade policy as a determinant of export activity and/or success of SMEs. The OECD study (2006) argues that as overcoming trade barriers required both time and resources, SMEs might be unable or unwilling to use government consultations mechanisms or offers to deal with trade barriers in foreign markets (OECD, 2006: 12). Likewise, the UPS study (2014) suggests that export success only partially relates to a low cost base while SME respondents considered product and service quality, the

strength of their customer relationships, logistics as well as pricing as more decisive determinants of export success.

While there is no literature on trade preferences specifically of SMEs, there is a large literature on trade preferences of businesses in general. Early contributions to the political economy literature focus on industries, grouping them into import-competing and export-oriented industries. Based on either their use of production factors or their comparative advantage, these contributions derive the preferences of industries with regard to protectionism or trade liberalisation (for a comprehensive review of this literature see e.g. Milner, 1999).

The “new” new trade theory (Melitz, 2003) introduces firms as a unit of analysis, assumes heterogeneous productivity of firms within the same industry and thus derives their preferences on protectionism or liberalisation from their productivity level. It assumes that only productive firms can cover the fixed costs of export activities, e.g. certification processes or the establishment of local production facilities. As liberalisation lowers trade barriers, competition increases among firms. New” new trade theory thus postulates that high-productivity firms can claim increasing market shares under enhanced competition and thus prefer liberalisation, whereas low-productivity firms face falling market shares and thus prefer the maintenance of status quo protection.

Trade theory linked to the literature on global value chains (Gereffi, Humphrey & Sturgeon, 2005) adds the position of firms in global value chains, i.e. the distribution of different production steps in worldwide production networks across several countries, as a determinant of trade preferences. This literature distinguishes between producers of intermediate inputs and finished goods. According to global value chain theory, both productive producers of intermediate inputs and finished goods prefer the liberalisation of trade in intermediate inputs as they rely on efficient imports from suppliers in third countries. It also stipulates that productive producers of finished goods have little incentive to lobby for liberalisation as they are already productive under the status quo, but unproductive firms have to lose from liberalisation and are therefore likely to mobilise resources in order to defend the status quo.

With regard to trade preferences of business on TTIP, Dür and Lechner (2014) analyse business contributions to Commission consultations on TTIP. They find both EU and US industries are more concerned with non-tariff than tariff trade barriers and demand a comprehensive liberalisation of trade. While they also find strong differences across sectors

and between EU and US industries, the adoption of international standards and mutual recognition were the most preferred outcomes.

In sum, the theoretical literature on trade preferences deduces preferences of firms on trade liberalisation or protectionism from a) the factor allocation of the country in which they are active and the relative use of these production factors by the industry to which they belong, b) their productivity and c) their position in global value chains. Although empirical studies do not strictly test these theoretical approaches, they find business demands for comprehensive trade liberalisation through the abolition of tariff and non-tariff barriers which do not contrast these theoretical predictions. There is, however, neither a theoretical nor empirical discussion of the formation and representation SME preferences in TTIP. Moreover, as all theoretical approaches build on rational choice theory, they assume that the trade preference of a firm can be deduced based on firm characteristics, but do not theoretically allow for the possibility that a firm may not have a preference on trade policy.

### **3.2 The Representation of Business Preferences in EU Policy-Making**

To understand how SME preferences can be represented in the TTIP negotiations, this section reviews a part of the literature on interest group strategies on EU policy-making. Contributions to this literature often distinguish between direct individual action (i.e. the firm lobbies by itself) or collective action (i.e. the firm lobbies through a business association). A potential strategy is also not to engage in any action or lobbying. The literature discusses among others the resources of interest groups, their actor type and issue characteristics as potential determinants of interest group strategies. Moreover, the literature discusses differences in interest representation across EU member states, e.g. Kohler-Koch, Quittkat and Kurczewska (2013) or Eising (2007).

Business associations are assumed to have clearly defined constituencies for which policy outcomes entail concentrated costs and benefits. These are believed to ensure that firms have an incentive to monitor the activities of the business associations of which they are a member (Dür & Mateo, 2013). Besides, the literature argues that business actors are assumed to have specialised information that is demanded by decision-makers, making it easier for them to gain access to decision-makers (Bouwen, 2004).

Mahoney (2008), Beyers and Kerremans (2012) and Rasmussen et al. (2014) find that interest groups are more likely to engage in lobbying if an issue is salient and likely to entail costs. Likewise, Woll (2005) notes that highly technical and complex policy issues reduce the likelihood of interest group lobbying. Dür and Mateo (2013) claim that issue characteristics and resources mediate the effect of the actor type on interest group strategies. An emerging literature (Dür & Mateo, 2014) argues that public opinion interacts with the strategies of interest groups because the public salience of an issue and interest group lobbying can reinforce each other. As non-governmental organisations and citizen groups increase the public salience of an issue by engaging in outside lobbying, they increase incentives for other interest groups to become active, thus further raising the public salience of an issue. At the same time, individual member firms, especially producers of consumer goods and services, may be reluctant to associate their names with unpopular issues for fear of losing customers, thus deterring business lobbying or at least individual firm lobbying (Dür & Mateo, 2014: 1204).

A major shortcoming of this literature is that it primarily examines large firms and business associations, but does not address SMEs. Both assumptions applied to large firms, i.e. that concentrated costs and benefits of possible policy outcomes provide them with incentives to monitor the activities of business associations and that they can supply specialised information to decision-makers may be called into question for the case of SMEs. Moreover, the high public salience of the TTIP negotiations especially in Germany (Bauer, 2015) is likely to affect SMEs differently than large firms and thus provides a good case to generate further hypotheses about the relationship between issue salience and the strategies of interest groups.

#### **4. Method**

Studying the preferences and lobbying strategies of SMEs tends to be difficult as access to owners is restricted. Unlike large firms or business associations, SMEs do not employ public affairs officials, but all political action is usually carried out personally by its owner or chief executive officer (Interviews SME Representatives 1,3; Interviews Business Association Representatives 1,2). With the time constraints resulting from their simultaneous obligations

as their firms' chief executive officers, many SME owners tend to have only little time to participate in research. Moreover, many SME owners deliberately prefer to remain "hidden" as part of their business strategy and thus refrain from visible public or political action (Simon, 2007). This exacerbates the access problems for researchers to SMEs compared with well-known access problems of researchers to experts in large firms or business associations (e.g. Woll, 2009). Fifteen initial interview requests sent out to SMEs by e-mail did not yield any positive replies.

While existing studies mostly seek to mitigate the access problem to SME owners by designing structured questionnaires that can be completed fast and by distributing them through mailing lists e.g. of business associations, this study has chosen to focus on in-depth insights from a limited sample of expert interviews. Through personal contacts and subsequent snowball sampling, six chief executive officers of SMEs kindly agreed to semi-structured in-depth expert interviews on their preferences and potential strategies on TTIP. All potential interview partners contacted in this way agreed to the interview request. Out of the firms interviewed, two firms were small firms, two medium-sized firms and two firms had slightly above 250 employees, but fulfilled the ownership and management criteria for "Mittelstand" otherwise. Moreover, the interviews showed that the interview partners displayed large variation on characteristics such as the export activities and orientation of their firm, their level of engagement in business associations as well as their assessment of the activities of business associations. Besides, four in-depth semi-structured interviews were conducted with representatives of the three German business associations considered in the empirical analysis as well as a Member of the German Parliament. The interviews took place between November 2014 and July 2015 and lasted between 30 and 60 minutes each. Eight out of the eleven interviews were conducted face-to-face, the other three via telephone. All interview partners requested to remain anonymous. Furthermore, I participated in a practitioners' workshop on challenges for SMEs in expanding business activities to the US which was organised by a German business association in February 2015.

The empirical chapters of this study contrast the insights obtained through the expert interviews with results of existing surveys on SME trade preferences by international organisations, business associations and firms. Moreover, this study also analyses and compares position papers of relevant cross-sectoral business associations, i.e. "Deutscher Industrie- und Handelskammertag" (DIHK), "Die Familienunternehmer-ASU" and "Bundesverband der mittelständischen Wirtschaft" (BVMW).

Compared to existing large-n studies, this approach offers a number of advantages. First, interviews with the owners of SMEs who are responsible for the direct political action of a firm as well as its contribution to collective action enhance the reliability of the data obtained. Second, the consent of all contacted potential interview partners approached through personal contacts and snowball sampling may provide a broader variety (although not representativeness) of respondents than existing large-n surveys distributed by e-mail. Third, the semi-structured question format of the interviews allows exploring unexpected answers which are likely to be omitted by structured questionnaires.

At the same time, this choice of research design requires elaboration on a few caveats. The small size of the sample of interview partners does not allow drawing general conclusions beyond the scope of this study. Generalisability is, however, also not the objective of this study. Instead, this study seeks to generate testable hypotheses which can subsequently guide future research.

Generalisability is particularly limited because only German SMEs and business associations were interviewed and institutional structures for SMEs and business associations alike are likely to be different in other countries. The hypotheses I seek to generate particularly on the role of business associations in shaping the formation of preferences among SMEs are likely to be specific to the German system of interest representation. Germany is, however, an interesting case as it has both a large share of SMEs that are highly involved in export activities (Simon, 2007) and SME business associations with strong organisational capacities (Traxler, 2005; Krickhahn, 1995).

SME preferences are certainly not only represented by cross-sectoral business associations which are analysed in this study, but also by sectoral associations (cf. Grote & Lang, 2009). However, sectoral business associations not explicitly seek to represent preferences which only pertain to SMEs (Interview SME representative 2). Cross-sectoral SME associations, on the contrary, need to justify their activities vis-à-vis members and decision-makers by representing positions which they consider to be particularly relevant for SMEs (for a theoretical framework on the positioning of business associations see Streeck & Schmitter, 1999). This given them a crucial role in the identification of SME-specific preferences.

The selection of cross-sectoral SME business associations whose position papers I analyse has admittedly an effect on the hypotheses I seek to generate. This selection is, however, not random. The selected business associations are the only German cross-sectoral SME associations which have published position papers on TTIP. Besides, DIHK and BVMW

participate in the TTIP Advisory Group of the German Federal Ministry of Economics and Energy as representatives of SMEs. Moreover, among the cross-sectoral associations firm interview partners most frequently named DIHK and “Die Familienunternehmer-ASU” as business associations representing their preferences.

## **5. Preference Formation of SMEs on TTIP**

If German SMEs have preferences on TTIP, these primarily relate to a reduction in non-tariff trade barriers. The interviews conducted for this study appear to confirm the findings of existing surveys (UPS, 2014, DIHK, 2015, Commission, 2015) that if SMEs report impediments to market access to the US which are related to trade policy, they mostly involve non-tariff trade barriers(cf. illustration 1). These broadly fall into two categories. On the one hand, SMEs in surveys report technical measures such as technical barriers to trade (TBTs) and health and phytosanitary regulations (SPS measures). Depending on the product and industrial sector of an SME, these are different national certification procedures between the EU and the US, including different mandatory product requirements demanding product changes for the US market, extra national testing and/or certification requirements for products as well as additional documentation requirements (Commission, 2015: 16-24). On the other hand, SMEs put forward customs rules and procedural barriers as impediments to market access in the US, e.g. extensive and complex documentation requirements and lack of access to information about documentation requirements (OECD, 2006: 9). In the interviews, SME owners whose firms were highly active in export activities with the US explained that customs and administrative entry producers required additional administrative capacity in their firm, thus raising costs and prolonging delivery times to customers (Interviews SME Representatives 2,3). Moreover, two respondents underlined that technical barriers such as different mandatory product requirements would theoretically raise production costs “by up to 20% compared with costs for products for the EU market” and thus prevent them from exporting some of their products at all (Interview SME Representative 2). A 20% cost surcharge would drive them out of a competitive market position with US competitors even if they could offer better product quality while the small market volumes served would not allow a profitable operation of a separate production line (Interviews SME Representatives 2,3).

Two respondents also stressed the need for an abolition of tariffs in TTIP. They noted that tariffs around 5% in their respective sectors, although they were low, considerably reduced

their profit margin if they wanted to remain competitive with US competitors or large EU firms which could afford to produce in the US and thus avoid tariff payments (Interview SME Representative 2).

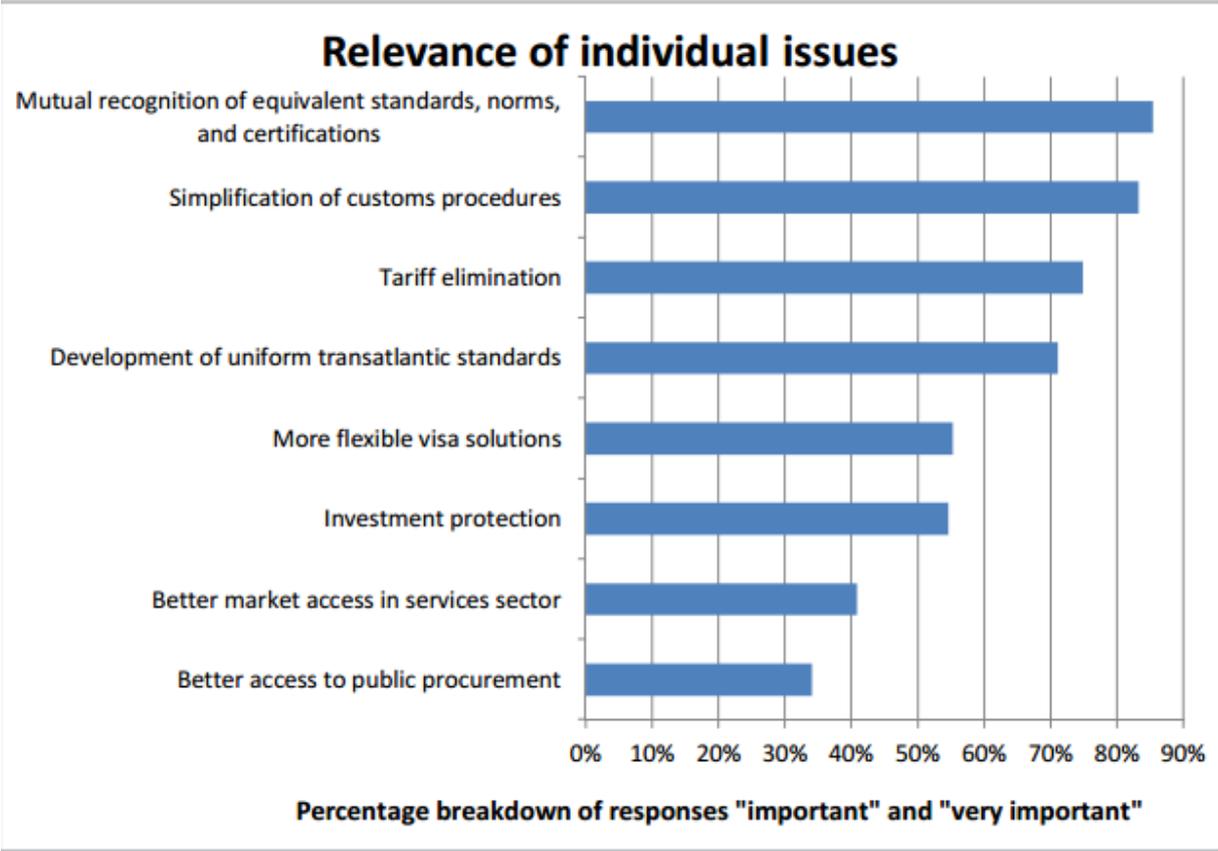


Illustration 1: DIHK results on priorities of survey respondents on TTIP (DIHK, 2015: 6)

Four out of six SME interview partners, however, seemed not to have specific preferences on TTIP. As a preference is a necessary precondition for lobbying as a strategy to realise the preference, the apparent absence of preferences of some German SMEs on TTIP is a likely first reason why lobbying on TTIP by SMEs is limited.

One reason for the apparent absence of specific TTIP preferences may be that many SMEs do not consider trade policy barriers as decisive barriers to their market opportunities in the US. This hypothesis is in line with the conclusion of the OECD (2006) study that for many SMEs, internal capabilities are a bigger limitation to an expansion of their business activities to the US than trade policy barriers (OECD, 2006: 12). Internal capability constraints are for instance to market knowledge, service capacities or the ability to deal with a different legal system. One interview partner noted that in order to sell his product on a foreign market, he needed to be able to guarantee service. Without a reliable service partner on the foreign

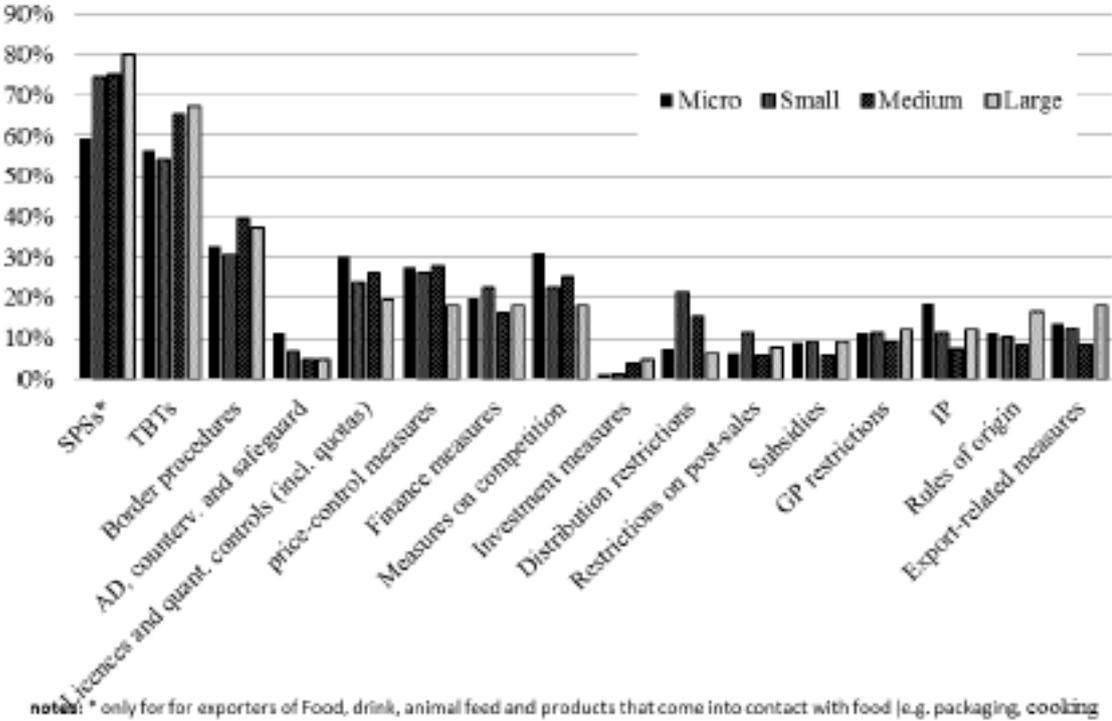
market, he would not consider market entry even in the absence of tariff and non-tariff barriers (Interview SME Representative 2). Another interview partner pointed out that his firm was reluctant to sell on the US market because it did not have sufficient market knowledge about consumer tastes and optimal marketing strategies for the US market to adapt the product for sale in the US (Interview SME Representative 4). Interview partners also raised a number of other concerns, e.g. differences in product liability law between Germany and the US, stressing they considered US rules on product liability a risk for their firm without extensive legal expertise (Interview SME Representatives 4,6). As a first hypothesis, this study thus puts forward that SMEs do not form trade policy preferences if they view internal capacities as bigger export barriers than factors in their business environment.

Moreover, this study gathered evidence suggesting that at least on trade policy, some SME owners may not see contradictions between potential preferences of SMEs and the preferences of large firms. All but one interview partner noted that preferable outcomes to SMEs were not necessarily in conflict with preferable outcomes to large firms. All interview partners believed, however, that burdensome customs or certification procedures were relatively more costly for SMEs than for large firms partly because large firms could afford to establish trade departments that develop expertise on documentation and certification requirement. One interview partner outlined that large firms were in his opinion also less concerned with technical barriers because they had production facilities in the US anyway and could thus easily adjust production to US production requirements (Interview SME Representative 2). Nonetheless, most interview partners considered burdensome customs or certification procedures or technical barriers to trade being counter to the preferences of large firms. Moreover, no interview partner held a negative opinion about the lobbying activities of large firms on TTIP. On the contrary, three interview partners stressed they welcomed better business opportunities for large firms in the US as these would also enhance their own sales of supply goods to large firms (Interview SME Representatives 2,3,5). Likewise, no interview partner feared rising competition because of TTIP. Two interview partners explained that as SMEs they had to develop niche strategies, which forced them to deliver continuous product innovation rather than dominate established markets (Interview SME Representative 1, 6). Another interview partner stressed that his business strategy was already adjusted to high competition as competition was already high at present levels with the ability of large finished good producers to source from various suppliers of intermediate inputs (Interview SME Representative 2). Protectionism to avoid higher competition was thus not a viable preference for SMEs regardless if they had currently high or low export activities. This supposed

preference for or indifference towards liberalisation appears to confirm the theoretical predictions of the literature on the “new” new trade theory and global value chains.

Two interview partners believed, however, that large firms had less incentive to invest lobbying resources on non-tariff trade barriers as many of them were already successful exporters under existing rules (Interview SME Representatives 2, 4). Only two interview partners implied that large firms, once they had developed expertise on customs and certification rules, might use complex rules as a comparative advantage to fend off competition from smaller firms (Interview SME Representatives 3,6). A potential alignment of interests of large firms is in line with existing survey results. The OECD (2006) argues “the incidence of trade policy barriers is normally the same for small and large companies”, but trade policy barriers likely to pose more severe constraints on market opportunities for SMEs (OECD, 2006: 6). The Commission (2015) survey results show that SMEs and large firms largely agree in their identification of trade barriers in trading with the US (see illustration 2).

**Figure 2.1. Reported trade barriers – Goods, by firms' size**



Source: Commission staff calculations from survey's replies.

Illustration 2: Commission SME survey on TTIP results on reported trade barriers (Commission, 2015: 16)

A perceived alignment of trade policy interests of SMEs and large firms may be another reason why SMEs may not form trade preferences. Following this hypothesis, SMEs would leave lobbying activities on TTIP to large firms and concentrate on eliminating internal capability constraints to enhance their export activities. At the same time, one interview partner noted that although trade liberalisation was in principle likely to be highly advantageous for his firm, he perceived trade policy as a “large firm affair”. (Interview SME Representative 1). Policy-makers were mainly interested in input from large firms because they held many jobs, but it was almost impossible for SMEs to influence trade policy (Interview SME Representatives 1,6). Only if SMEs believe that large firms pursue different interests than those of SMEs, they may be more inclined to form preferences themselves. This leads to the formulation of a second hypothesis: SMEs do not form trade policy preferences if they view large firm preferences as congruent to their own potential preferences.

Not all SME owners seemed to assess internal capability constraints and factors in the business environment as equally important impediments to market access to the US (Interview SME Representatives 3,5). This follows existing studies which imply that differences in the assessment of the relative importance of these factors may relate to the current export activities of a firm. The OECD (2006) finds that “non-active exporters tend to be more concerned with financial and access barriers whereas firms that are already exporters prioritise issues related to the overall business environment, including trade barriers.” (OECD, 2006: 5) The interviews conducted for this study, however, also suggest that respondents who stated to be active in a business association were more aware of trade barriers (Interview SME Representatives 2,3,5). Moreover, those interview partners who held positions in a business association displayed extensive knowledge of regulatory processes both in the EU and the US and explained potential obstacles for the Commission in the TTIP negotiations in achieving the reduction of non-tariff barriers and ambitious regulatory convergence. This gives rise to one further hypothesis: SMEs form trade policy preferences if their owners hold an office in a business association that takes action on trade policy.

## **6. SMEs business associations and trade preference formation among firms**

With the likely reluctance of member SMEs to form trade policy preferences on TTIP, especially business associations representing SMEs can thus not only rely on the aggregation of member preferences, but also need to form preferences themselves. The direction of causality between input from members and the positions represented by an association is empirically difficult to disentangle. However, preferences can be considered to originate from officials of a business association if issues articulated in position papers ranks low among firms in firm surveys.

Although some SME owners appear to engage in individual lobbying on TTIP (Interview SME Representative 2), the majority seems to rely on business associations for interest representation. Business association representatives stated they offered briefings for SME representatives before meetings or dialogues with decision-makers on TTIP (Interview Business Association Representative 3). SME owners, however, questioned the efficacy of business associations in communicating with their members various times in the interviews. Indeed, this raises the question how business associations (and policy-makers) should communicate with SMEs to identify business challenges and develop policy responses. Moreover, it raises the question to what extent business associations also develop preferences to pursue own interests, e.g. strengthen their visibility towards decision-makers and members. Neither question can, however, be addressed within the scope of this study.

All SME associations studied in this survey stress the reduction of NTBs and elimination of remaining tariffs as priorities of a potential TTIP agreement, thus reflecting outcomes of consultations. An example where preferences are, however, likely to have been formed by business associations rather than through an aggregation of member firm preferences is the treatment of rules of origin in TTIP. Rules of origin determine the national origin of a product and thus determine which products benefit from preferential market access granted in a bilateral free trade agreement. In practice, firms may often not use rules of origin because compliance and implementation costs with existing rules of origin exceed tariff savings especially because existing tariffs with the US are already relatively low. Nonetheless, for SMEs, different rules of origin across economies and free trade agreements may be an export barrier that prevents them not only from exporting, but also from engaging with and forming a preference on rules of origin. DIHK thus demands that “rules of origin have to harmonised as far as possible to facilitate trade. Especially SMEs need rules of origin which are easy to understand and apply.” (DIHK, 2014: 2). Likewise, DIHK presents extensive preferences on the abolition of NTBs related to customs rules and procedures (DIHK, 2014: 10). As DIHK offers consultation services and assistance services to members on the compliance with rules

of origin and customs procedures (Interview Business Association Representatives 2,4), it is likely to have knowledge of its members' difficulties in complying with these rules. The prioritisation of a harmonisation of rules of origin as a TTIP preference of DIHK contrasts with the low importance survey respondents attached to rules of origin in the Commission survey (Commission, 2015). Knowledge of challenges for SMEs enables business associations to form preferences on issues and propose preferred outcomes even where SMEs may not have preferences themselves.

Personal contacts of business association representatives with SME owners beyond position papers and briefings for stakeholder meetings may be a channel to transmit preferences of business associations to members and lead to their adoption by members. Where associations choose to remain inactive (DIE FAMILIENUNTERNEHMER or BVMW have not published a position paper on another free trade agreement, DIHK activities on other free trade agreements also appear to be lower), these preferences may not be formed. This implies a fourth hypothesis for future research: SMEs are more likely to form trade policy preferences if business associations of which they are a member adopt SME-specific policy positions.

Moreover, SMEs may be discouraged from forming a preference on TTIP because high uncertainty with regard to likely outcomes of the negotiations may reduce the expected returns on lobbying. Uncertainty may be particularly high if an issue is publicly salient. A German MP believed that the public salience of the TTIP negotiations discouraged SMEs from lobbying on TTIP because they were concerned about reputation damages if they positioned themselves positively on an issue which faced heavy criticism from non-governmental organisations and citizen groups (Interview Member of Parliament 1). Moreover, an SME owner also stressed that unlike large firms with professional policy departments, he would have to position himself personally, but was unwilling and unable to respond to the kind of personal criticism he feared particularly through online media (Interview SME Representative 1). This point was reiterated by business association representatives (Interviews Business Association Representatives 1,2). The UPS survey (2014) confirms that although German SMEs were more aware of TTIP than SMEs in other countries, they were also more uncertain about its effects than SMEs in other EU member states. High public salience may thus deter SMEs from engaging in lobbying and forming a preference on TTIP. This leads to a fifth hypothesis: SMEs do not form trade policy preferences if they view trade policy as publicly salient.

SME business associations not only position themselves on potentially SME-specific trade barriers, but also respond to the public criticism on TTIP which is likely to be a source of uncertainty for SMEs. DIHK, DIE FAMILIENUNTERNEHMER and BVMW all adopt a position on the controversially discussed investor-state dispute settlements (for an analysis of this controversy see Eliasson, 2015). However, they differ substantially on their respective preferences. DIHK states that “investment protection is important, but not at any cost”, adding that “for German companies investment protection with the US is not a key topic.” (DIHK, 2014: 3). DIE FAMILIENUNTERNEHMER write that “investment protection deserves a lot of attention and that there are good reasons to include it in the TTIP agreement.” (Die Familienunternehmer, 2014: 18). Moreover, “investment protection may not be construed as entitlement to compensation for any expected returns that do not materialize. Investment protection should only focus on cases where foreign investors are discriminated against when compared to domestic investors.” (Die Familienunternehmer, 2014: 1). BVMW, on the contrary, writes that “Mittelstand rejects investment protection in its current form. SMEs have neither the financial means nor the time to be involved in lengthy judicial proceedings. Investor-state dispute settlements favour large corporations which can thus circumvent applicable national law and national jurisdiction.” (BVMW, 2014).

An analysis for the reasons of the differences in these positions is beyond the scope of this study. Nonetheless, the focus and differentiation of SME business associations on this issue appear striking given that according to existing surveys investment protection does not appear to be a high priority of SME respondents (DIHK, 2015; Commission, 2015). Business associations may, however, decide to position themselves on publicly salient issue because they want to signal the preferences of the association to the members as well as to provide background information to members. This information may alleviate some of the uncertainty SMEs feel with regard to the public criticism and push them to form preferences on TTIP. This leads to an extension of the fourth hypothesis: SMEs form trade preferences if business associations position themselves on publicly salient trade issues.

## 7. Conclusion

As noted above, this is an initial study on the formation and representation of German SME preferences in the TTIP negotiations which does not aim at obtaining generalizable results. Nonetheless, this study has generated some hypotheses which can be tested in future studies.

Empirically, this study gives rise to the hypothesis that both the formation and representation of SME preferences in the TTIP negotiations is limited because many SMEs prioritise other export barriers than trade policy barriers. Many SMEs may not form trade preferences as they think that their interests are already represented by large firms. This study hypothesises, however, that SMEs are more likely to form trade preferences if their owners are politically active in a business association. These hypotheses should be compared with hypotheses implied by extant studies that SMEs are more likely to consider trade policy barriers if they have large export activities, but may be apathetic to trade policy because/if they think their voice is not heard.

This study, however, suggests that SME business associations may enhance the formation of trade and TTIP preferences in SMEs if they represent SME-specific issues and explain the relevance of these issues to SMEs. This takes into consideration that the formation of preferences in business associations is likely to be also influenced by factors which were not examined in this study. This study has generated ambivalent hypotheses on the effect of public salience of the TTIP negotiations on the preference formation among SMEs. It hypothesises that SMEs are less likely to form trade preferences if an issue is publicly salient because they fear reputation damages. SME business associations may, however, encourage the formation of TTIP preferences among SMEs if they represent positions on publicly salient issues and thus reduce uncertainty among their members.

Theoretically, this study implies that in particular SMEs do not necessarily per se form a preference on trade policy. They may, however, instead internalise preferences which have been formed and shaped by business associations. This study suggests that whether SMEs

form preferences on a policy issue may crucially depend on political processes and the responses of business associations to political processes. These hypotheses lend support to the endogeneity hypothesis in the literature on business preference formation.

While this study did not find evidence contradicting the theoretical predictions of the recent economics trade preference literature, its inductive approach implies a bigger consideration of potentially lacking preferences among SMEs in future research. Moreover, the hypotheses generated in this study contribute to the growing literature on the effect of issue salience and public opinion on interest group strategies on EU policy-making.

Future research could examine if organisational characteristics of business associations influence the degree to which extent members adopt association preferences. If future research can find support for the hypotheses of this study, it would strengthen the case for business associations to provide SMEs with expertise in order to overcome internal capability constraints. It would also underline the benefits for business associations to further encourage activities of SMEs within associations and involve them in position-building and lobbying. Moreover, it would imply the need for SME business associations to focus on SME-specific issues and to explain and position themselves on publicly salient issues, thus seeking to reduce uncertainty for member firms. All these steps might help improve the involvement of SMEs in EU trade policy-making both in TTIP and beyond.

## **List of interviews**

SME Representative 1	11 January 2015
SME Representative 2	26 January 2015
SME Representative 3	31 January 2015
SME Representative 4	6 February 2015
SME Representative 5	24 February 2015
SME Representative 6	14 March 2015
Business Association Representative 1	5 February 2015
Business Association Representative 2	23 February 2015
Business Association Representative 3	24 March 2015
Business Association Representative 4	12 May 2015
Business Association Representative 4	6 July 2015
Member of German Parliament 1	18 November 2014

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